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## Countertrade, the GATT, and the Theory of the Second Best

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# Countertrade, the GATT, and the Theory of the Second Best

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## I. INTRODUCTION

The term "countertrade" refers to barter and barter-like international trade. International barter has always existed and has not vanished even from the post-World War II multilateral payments system.<sup>1</sup> To the contrary, countertrade has grown rapidly<sup>2</sup> and spread widely,<sup>3</sup> prompting commentators to affirm that it has become a permanent feature of the world economy.<sup>4</sup>

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1. See, e.g., I. OUTTERS-JAEGER, *THE DEVELOPMENT IMPACT OF BARTER IN DEVELOPING COUNTRIES* 11-15 (1979); Carey & McLean, *The United States, Countertrade and Third World Trade*, 20 J. WORLD TRADE L. 441, 442-44 (1986).

2. See, e.g., Comment, *The Need for a United States Countertrade Policy*, 7 NW. J. INT'L L. & BUS. 113, 114 (1985). The magnitude of countertrade is difficult to assess because reliable data are scarce. See, e.g., de Miramon, *Countertrade: A Modernized Barter System*, OECD OBSERVER, Jan. 1982, at 12, 12. Thus, "[e]stimates of the share of world trade accounted for by countertrade vary tremendously." BUSINESS INT'L CORP., RESEARCH REP. NO. 154, *THREATS AND OPPORTUNITIES OF GLOBAL COUNTERTRADE* 14 (1984). Estimates range from 1%-40% of world trade. ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, *COUNTERTRADE: DEVELOPING COUNTRY PRACTICES* 11 (1985) [hereinafter OECD (1985)]. See, e.g., *id.* at 12 (OECD estimate: 4.8% of world exports); BUSINESS INT'L CORP., *supra*, at 14 (GATT estimate: 8% of world merchandise trade); Verdun, *Are Governmentally Imposed Countertrade Requirements Violations of the GATT?*, 11 YALE J. INT'L L. 191, 192 (1985) (IMF estimate: 5%-10% of world trade); Lochner, *Guide to Countertrade and International Barter*, 19 INT'L LAW. 725, 726 & n.1, 733 & n.48 (Department of Commerce official's estimate: 20%-30% of world trade). The growth of countertrade may be accelerating, see, e.g., Comment, *supra*, at 122-23; but see Watson, *Trading in a Cold Climate as the Competition Hots Up*, TRADE FIN., Sept. 1987, at 37, 39 (some traders see stagnant countertrade market), and countertrade terms are hardening, see, e.g., de Miramon, *supra*, at 13. Countertrade has "gathered considerable momentum," OECD (1985), *supra*, at 9, and some experts predict continued growth, Comment, *supra*, at 124. But see Watson, *supra*, at 39 (some traders see countertrade at plateau).

3. Long a staple of East-West trade, countertrade has recently assumed an important place in trade between industrialized countries and developing countries. E.g., BUSINESS INT'L CORP., *supra* note 2, at 16-17. During the period 1980-1985, 61 countries imposed countertrade requirements at one time or another. Assessment of the Effects of Barter and Countertrade Transactions on U.S. Industries, USITC Pub. 1766, Inv. No. 333-185, at 46 (1985) [hereinafter USITC (1985)].

4. E.g., Carey & McLean, *supra* note 1, at 441.

This sudden prominence has aroused concern that countertrade distorts multilateral trade and threatens the integrity of the General Agreement on Tariffs and Trade (GATT),<sup>5</sup> which provides the legal framework for international trade. This Article argues that such concern is unwarranted. Part II of this Article defines countertrade and separates it into three categories. Part III then develops a defense of countertrade as a second-best policy that enhances international trade. Part IV applies this economic analysis to the legal analysis of countertrade under the GATT. Part V delineates the appropriate institutional response to these analyses. Part VI concludes that countertrade as a second-best policy supplements and complements the GATT system and does not violate GATT provisions.

## II. DEFINING COUNTERTRADE

The term "countertrade" describes a "multitude" of commercial arrangements with a "bewildering array of names."<sup>6</sup> As a result, "[t]here is no universally accepted definition of countertrade,"<sup>7</sup> although definitions abound.<sup>8</sup> For the purposes of this Article, countertrade is the contractually explicit linkage of commercial import and export transactions.<sup>9</sup>

Neither is there a set of agreed-upon terms for the various types of countertrade.<sup>10</sup> All countertrade transactions, however, may be described according to six variables: relative duration, size of deal, number of contracts, form of payment, value relationship of deliveries, and relationship of countertraded products.<sup>11</sup> Using these variables, counter-

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5. General Agreement on Tariffs and Trade, *opened for signature* Oct. 30, 1947, 61 Stat. A3, T.I.A.S. No. 1700, 55 U.N.T.S. 194 [hereinafter GATT]. Other GATT documents appear in CONTRACTING PARTIES TO THE GENERAL AGREEMENT ON TARIFFS AND TRADE, BASIC INSTRUMENTS AND SELECTED DOCUMENTS (periodic supplements) [hereinafter BISD].

6. Banks, *The Economics and Politics of Countertrade*, WORLD ECON., June 1983, at 159, 159.

7. Carey & McLean, *supra* note 1, at 441.

8. Guyot, *Countertrade Contracts in International Business*, 20 INT'L LAW. 921, 922-23 (1986) (listing definitions).

9. See, e.g., Banks, *supra* note 6, at 159. Thus, arrangements such as equity joint ventures and military offset agreements, see generally Guyot, *supra* note 8 at 943-58, are beyond the scope of this article. See BUSINESS INT'L CORP., *supra* note 2, at 67 (offset distinguished from commercial forms of countertrade); Comment, *supra* note 2, at 121 n.60 (offset not contractual).

10. Lochner, *supra* note 2, at 728.

11. L. WELT, COUNTERTRADE BUSINESS PRACTICES FOR TODAY'S WORLD MARKET 14 (1982). For a summary of contractual considerations, see *id.* at 32-39; Hober, *Countertrade: Negotiating the Terms*, INT'L FIN. L. REV., Mar. 1987 (Part I), Apr. 1987 (Part II). For annotated sample contracts, see Koschik, *Structuring Barter and Countertrade Transactions*, in

trade may be divided into three categories: classical barter, commercial compensation, and industrial compensation.<sup>12</sup>

### A. Classical Barter

In classical barter transactions, there is only one contract, and no money changes hands.<sup>13</sup> Also, there is no necessary relationship between the products traded, the value of reciprocal deliveries must balance in some manner, and the time frame is usually short. Pure barter is the most primitive form of international trade; it depends on simultaneity, exact equality of value, and strict coincidence of wants.<sup>14</sup> Despite the ad hoc nature of pure barter, countries such as the Philippines and Egypt use it often.<sup>15</sup> Moreover, a variant of pure barter called "swap" can save transaction costs in commodities trade. Recently, Mexico was slated to ship oil to Western Europe, and the Soviet Union was preparing to send oil to Cuba. The participants worked out a swap arrangement sending Mexican oil to Cuba and Soviet oil to Western Europe.<sup>16</sup>

Traders have developed means of overcoming the inflexibility of pure barter; many countries maintain bilateral clearing arrangements.<sup>17</sup> An umbrella document specifies which products can be traded, and the value of imports and exports is tabulated in a "clearing account" so that no money changes hands at the time of trade.<sup>18</sup> Usually, the bilateral partners settle the outstanding balance (the "swing") at fixed periods. Many clearing arrangements permit "switch" trading, in which an outside trader may alleviate the bilateral swing by taking goods listed for

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BARTER IN THE WORLD ECONOMY 37-82 (B. Fisher & K. Harte eds. 1985). For diagrams of typical countertrade transactions, see BUSINESS INT'L CORP., *supra* note 2, ch. 3. For fourteen case studies of countertrading entities, see *id.* ch. 9. Barter-like trade also differs from country to country and region to region. For a review of national countertrade practices, see *id.* ch. 10. For a review of countertrade by region, see BUSINESS INT'L CORP., RESEARCH REPORT No. 160, 101 CHECKLISTS FOR COPING WITH WORLDWIDE COUNTERTRADE PROBLEMS chs. 6-10 (1985). For an in-depth examination of countertrade policies in Latin America, see Carey & McLean, *supra* note 1, annex I, at 456.

12. *Cf.* Guyot, *supra* note 8, at 925; Banks, *supra* note 6, at 160-62; de Miramon, *supra* note 2, at 13.

13. Guyot, *supra* note 8, at 925.

14. *Id.*

15. I. OUTTERS-JAEGER, *supra* note 1, at 34.

16. USITC (1985), *supra* note 3, at 45.

17. For a detailed description of bilateral clearing arrangements, see I. OUTTERS-JAEGER, *supra* note 1, at 38-40, 45-47. For a description of India's experience with bilateral clearing, see R. BANERJI, THE DEVELOPMENT IMPACT OF BARTER IN DEVELOPING COUNTRIES: THE CASE OF INDIA (1977). For a list of bilateral clearing agreements currently in existence, see BUSINESS INT'L CORP., *supra* note 2, at 78-79.

18. *See, e.g.,* Lochner, *supra* note 2, at 729-30.

export by the deficit country and selling acceptable goods to the surplus country.<sup>19</sup>

Classical barter permits trade when at least one party does not have access to convertible currencies. As a result, barter occupies a significant place in North-South and South-South trade. Classical barter accounts for roughly forty percent of all less developed country (LDC) trade.<sup>20</sup>

## B. Commercial Compensation

In commercial compensation, like classical barter, the time frame is short and the deliveries unrelated; however, the parties trade in cash and use more than one contract, and the value of reciprocal deliveries need not balance. These transactions take the form of a contractual triangle: the principle contract covers a standard cash-for-goods transaction; the counterpurchase contract specifies the conditions of the seller's obligation to purchase goods from the buyer; and a third contract, called a protocol, links the first two sets of contractual obligations. The first two contracts cover distinct transactions with separate payments.<sup>21</sup> The "counterpurchase ratio" may be any ratio of counterdelivery value to delivery value.<sup>22</sup> Usually, the seller can choose counterdeliveries (at market or otherwise specified prices) from a list. The counterpurchase contract typically permits the seller to assign its obligation to a third party.<sup>23</sup>

A deal concluded by General Electric and Romania illustrates the mechanics of commercial compensation. General Electric agreed to help build a nuclear reactor for \$160 million. The corporation took as payment \$160 million worth of Romanian cement, which was brokered by a German firm for use in Egypt.<sup>24</sup>

An important kind of commercial compensation is precompensation, in which the ultimate seller builds up an evidence account by purchasing listed export products from a country.<sup>25</sup> The seller then is free to sell products—up to the value in the evidence account—directly

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19. See, e.g., Verdun, *supra* note 2, at 196.

20. See Schwenk, *North-South Barter Trade*, in *BARTER IN THE WORLD ECONOMY* 94 (B. Fisher & K. Harte eds. 1985). See, e.g., Carey & McLean, *supra* note 1, at 459 (Brazil channels 30% of its total trade through clearing agreements).

21. Guyot, *supra* note 8, at 930. See generally Hober, *supra* note 11.

22. See Guyot, *supra* note 8, at 930. See generally Hober, *supra* note 11.

23. Guyot, *supra* note 8, at 930. For a discussion of methods for disposing of counterdeliveries, see McVey, *Overview of the Commercial Practice of Countertrade*, in *BARTER IN THE WORLD ECONOMY* 26-28 (B. Fisher & K. Harte eds. 1985) (use in production process, nonproduction in-house use, use by subcontractors, sale to ultimate user, and transfer to trading company).

24. Lochner, *supra* note 2, at 740 & n.93.

25. See, e.g., *BUSINESS INT'L CORP.*, *supra* note 2, at 59-61 (advance purchase); McVey,

into the countertrade-demanding country. Also noteworthy is "positive" or "reverse" countertrade; in such cases, "the private firm views the goods that it will be required to purchase as more valuable than hard currency."<sup>26</sup> Most critics of countertrade, however, direct their attention mainly to counterpurchasing,<sup>27</sup> perhaps because it is the most frequently practiced form of countertrade.<sup>28</sup>

### C. Industrial Compensation

In industrial compensation, as in commercial compensation, parties may use cash and multiple contracts, and the value of deliveries need not balance. Industrial compensation transactions, however, involve very large quantities and very long terms, and are distinguished by deliveries that are related to counterdeliveries. Buy-back is the quintessential industrial compensation form; it "involves the sale of plants, equipment or technology by one party to another and the payment for such sale in the form of products resulting from the plant, equipment or technology."<sup>29</sup> The best known example of industrial compensation, and perhaps the largest countertrade deal of all time,<sup>30</sup> is the Western Europe-Soviet Union natural gas pipeline.<sup>31</sup> Industrial compensation is used primarily for technology transfers which foster economic development,<sup>32</sup> and it is the fastest growing kind of countertrade.<sup>33</sup> Perhaps because industrial compensation is also used by Western firms to obtain scarce raw materials, it is the type of countertrade that faces the least resistance from Western governments.<sup>34</sup>

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*Countertrade: Commercial Practices, Legal Issues and Policy Dilemmas*, 16 LAW & POL'Y INT'L BUS. 1, 20-22 (1984) (progressive or proactive countertrade).

26. McVey, *supra* note 25, at 22.

27. See, e.g., Walsh, *The Effect on Third World Countries of Mandated Countertrade*, 19 J. WORLD TRADE L. 592 (1985) (criticizing countertrade but arguing largely in terms of counterpurchases).

28. E.g., BUSINESS INT'L CORP., *supra* note 2, at 56.

29. Guyot, *supra* note 8, at 948 (footnote omitted).

30. Lochner, *supra* note 2, at 741-42. The \$12 billion project will channel 40-50 billion cubic meters of natural gas annually through 3,000 miles of pipeline between Siberia and Western Europe. *Soviets Defend Siberia-to-W. Europe Pipeline Deal*, Wash. Post, Dec. 27, 1980, at D7, col. 3.

31. See Comment, *supra* note 2, at 120-21.

32. E.g., Guyot, *supra* note 8, at 949 n.102.

33. L. WELT, *supra* note 11, at 18.

34. de Miramon, *supra* note 2, at 12. Western governments subsidize such efforts. See generally Walsh, *The Growth of Develop-for-Import Projects*, RESOURCES POL'Y, Dec. 1982, 277. See also L. WELT, *supra* note 11, at 66; Verdun, *supra* note 2, at 197.

### III. POLITICAL AND ECONOMIC VIEWS OF COUNTERTRADE

Countertrade requirements, however, do impose burdens upon Western-based multinational corporations.<sup>35</sup> Also, the GATT envisions a world trading order characterized by the free flow of goods in return for cash, but countertrade represents a sharp deviation from the multilateral payments system. As a result, Western governments have been quick to condemn the use of countertrade by Eastern and Southern governments.<sup>36</sup>

Scholars have given substance to this condemnation by developing a general equilibrium critique of countertrade. In order to analyze this critique—as well as any defense—of countertrade, it is necessary to explore two related political-economic questions. First, why do international trade actors choose countertrade over the multilateral payments system? Second, what are the consequences of this choice for third parties and the world trading order?

#### A. The General Equilibrium Critique of Countertrade

Most writers attack countertrade as being against the interest of the immediate parties and as being detrimental to both third parties and the world trading order.<sup>37</sup> In comparison to ordinary cash transactions, countertrade seems costly. Barter-like transactions are complex;<sup>38</sup> therefore, negotiation and other transaction costs are high.<sup>39</sup> As a result, such transactions slow the trading process<sup>40</sup> and decrease flexibility.<sup>41</sup> Furthermore, countertrade alters the pattern of cash transactions.<sup>42</sup> Government imposition or encouragement of reciprocal trading appears to constrict consumption opportunities and production possibilities.<sup>43</sup>

35. See *infra* notes 38-43 and accompanying text.

36. See generally BUSINESS INT'L CORP., *supra* note 2, at 40-52.

37. See, e.g., Verdun, *supra* note 2, at 201; Walsh, *supra* note 27, at 596; Banks, *supra* note 6, at 177.

38. See, e.g., Lochner, *supra* note 2, at 747-50.

39. *Id.* at 747-48; Verdun, *supra* note 2, at 202; Banks, *supra* note 6, at 177 (more administrative and legal input).

40. Verdun, *supra* note 2, at 201-02; Banks, *supra* note 6 at 177.

41. *The Impact of Countertrade and Offset Agreements on the U.S. Economy: Hearings Before the Subcomm. on Economic Stabilization of the House Comm. on Banking, Finance and Urban Affairs*, 98th Cong., 2d Sess. 33-34 (1984) [hereinafter *Impact of Countertrade*] (statement of James P. Moore, Jr., Deputy Assistant Secretary of Commerce).

42. See Walsh, *supra* note 27, at 593 (package of countertrade offerings injects additional competitive element into commercial negotiations).

43. See Verdun, *supra* note 2, at 202 (production effect); INTERNATIONAL MONETARY FUND, 1983 ANNUAL REPORT ON EXCHANGE ARRANGEMENTS AND EXCHANGE RESTRIC-



Thus, critics of countertrade hold that "such practices are economically inefficient."<sup>44</sup> Why then do economic actors engage in inefficient practices? Explains a GATT economist, countertrade is "largely based on a misapprehension" by the contracting parties of the relevant incentives.<sup>45</sup>

The detractors of countertrade also assert that these inefficiencies reach beyond the countertrading parties; given an equilibrium in world markets, local distortions will reverberate throughout the system.

The purely economic argument is that bilateralism results in a *generalised* contraction of trade and production through trade diversion, resource misallocation and increased transaction costs. Multilateral trade is normally associated with trade imbalances between trading partners due to international specialisation and differences in the pattern and magnitude of demand. Any action to reduce disparities in bilateral trade flows will necessitate a switching of import expenditure to higher-cost sources. This will decrease not only the volume of imports but also the volume of domestic output, as a result of reduced demand and increased costs of supply. The depressive effect on trade and production is compounded by the increased costs of supply. The costs of a given volume of trade are thereby raised and the number of transactions possible in a given period of time are reduced.<sup>46</sup>

Furthermore, it has been suggested that barter-like trade is not only distortionary, but also inherently discriminatory.<sup>47</sup> Some commentators note the difficulty of monitoring countertrade<sup>48</sup> and assert that these transactions threaten to undermine the multilateral trade system.<sup>49</sup> To the extent that the GATT regime is itself a public good, practices which cause GATT norms to deteriorate harm the interests of all nations.

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TIONS, noted in *BUSINESS INT'L CORP.*, *supra* note 2, at 33 (countertrade limits choice). See also *Lochner*, *supra* note 2, at 747 (countertrade distortionary); de Miramon, *supra* note 2, at 14 (same). For a discussion of the gains from trade and from specialization on consumption and production, see C. KINDLEBERGER & P. LINDERT, *INTERNATIONAL ECONOMICS* pt. 1 (6th ed. 1978).

44. Verdun, *supra* note 2, at 201.

45. Banks, *supra* note 6, at 179.

46. *Id.* at 177. See Verdun, *supra* note 2, at 201 (countertrade interferes with comparative advantage); de Miramon, *Advantages and Disadvantages of Countertrade*, 5 J. COMP. BUS. & CAPITAL MARKETS L. 347, 351 (1983) ("regression towards bilateralism"); Walsh, *Countertrade: Not Just for East-West Any More*, 17 J. WORLD TRADE L. 3, 4 (1983) (distorts world trade flows).

47. Walsh, *supra* note 46, at 4. See de Miramon, *supra* note 2, at 14.

48. See, e.g., *Lochner*, *supra* note 2, at 749.

49. See, e.g., de Miramon, *supra* note 2, at 14 ("Extension of [countertrade] to an increasing proportion of international trade would create a special system, alongside the multilateral system . . ."). For a particularly troublesome example along these lines, see Walsh, *supra* note 27, at 597 (Malaysian Minister of Finance stated that his country was forced into countertrade to compete with Indonesian countertrade program).

In contrast to the existing multilateral payments system, reciprocal trade appears to be inflexible, costly, and distortionary. Countertrade exists outside the multilateral system and is difficult to monitor. Government intervention to encourage bilateral trade seemingly creates a global misallocation of resources. If world markets were in general equilibrium, countertrade would be inefficient.

## B. Defense of Countertrade

However, world markets are not in general equilibrium; distortions are widespread.<sup>50</sup> "We live in a 'second-best' world, one riddled with gaps between private and social benefits or costs."<sup>51</sup> This fact gives rise to persistent confusion pervading many contemporary analyses of countertrade:

Indeed, in many ways countertrade is a contradiction. Although countertrade undermines multilateral trading, it is the recent failures of the multilateral trading system which have in part given rise to countertrade and expedited its growth. . . . While countertrade can distort trade, it can also enhance trade.<sup>52</sup>

This confusion can be resolved by taking account of market imperfections explicitly and employing the theory of the second best.

### 1. The General Theory of the Second Best

The general theory of the second best "states that if there is introduced into a general equilibrium system a constraint which prevents the attainment of one of the Paretian conditions, the other Paretian conditions are . . . no longer desirable."<sup>53</sup> Therefore, "it is *not* true that a situation in which more, but not all, of the optimum conditions are fulfilled is necessarily, or is even likely to be, superior to a situation in which fewer are fulfilled."<sup>54</sup> As applied to international trade, the theory of the second best states that, even under the assumption that free trade is a

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50. C. KINDLEBERGER & P. LINDERT, *supra* note 43, at 135.

51. *Id.* One opponent of countertrade complains that such "governmental policies and practices interfere with international market forces for social or other noneconomic objectives." Walsh, *supra* note 46, at 4. This misses the point. Government intervention is entirely legitimate under conditions of market failure. Sometimes governments must bring economic and social benefits into line.

52. Lochner, *supra* note 2, at 759.

53. Lipsey & Lancaster, *The General Theory of Second Best*, 24 REV. ECON. STUD. 11, 11 (1956). For a discussion of paretian analysis, see R. POSNER, *ECONOMIC ANALYSIS OF LAW* § 1.2 (3d ed. 1986).

54. Lipsey & Lancaster, *supra* note 53, at 12.

welfare optimum, "not every step toward freer trade is desirable."<sup>55</sup>

Thus, there is no a priori way to choose between policies aimed at a given market failure.<sup>56</sup> It will be sufficient here to develop a realistic understanding of constraints within the trade system. Government actions encouraging countertrade will then be judged as either addressing these constraints or embodying policies that are impermissible under the GATT.

## 2. Countertrade as a Second-Best Policy

The theory of the second best is well suited to the analysis of countertrade.<sup>57</sup> Countertrade has been termed a "necessity"<sup>58</sup> and an "expedient."<sup>59</sup> Recent expansion of countertrade has coincided with worldwide economic troubles. In the face of economic and political rigidities, reciprocity allows trade which would not otherwise take place.<sup>60</sup> "The additional trade which takes place in this second best situation can be viewed as improving domestic economic welfare."<sup>61</sup> When this trade-creating effect outweighs the trade-distorting effect, countertrade increases global welfare as well.<sup>62</sup>

The creation-diversion distinction comes from the customs union literature,<sup>63</sup> which is an important case study in the theory of the second best.<sup>64</sup> As with all second best questions, it is impossible to say a priori

55. C. KINDLEBERGER & P. LINDERT, *supra* note 43, at 172.

56. Lipsey & Lancaster, *supra* note 53, at 12. Economists have developed the so-called specificity rule to cope with this problem. "It is more efficient to use those policy tools that are closest to the locus of the distortions separating private and social benefits or costs." C. KINDLEBERGER & P. LINDERT, *supra*, note 43, at 172.

57. See OECD (1985), *supra* note 2, at 21.

58. Comment, *supra* note 2, at 117.

59. L. WELT, *supra* note 11, at 61.

60. Lowenfeld, *Interface IV: Countertrade in Economic Relations Between East and West—An Introduction*, 5 J. COMP. BUS. & CAPITAL MARKETS L. 329, 331 (1983). See also Comment, *The Application of the General Agreements on Tariffs and Trade to the Countertrade Practices of Less Developed and Developing Countries: Proposed Amendments to the GATT*, 16 CAL. W. INT'L L.J. 312, 320 (1986).

61. OECD (1985), *supra* note 2, at 21.

62. Cf. J. VINER, *THE CUSTOMS UNION* ISSUE 44 (1961) (originally published 1950) (where trade-creating effect of custom union dominates trade-diverting effect, global welfare rises); Lipsey, *The Theory of Customs Unions: A General Survey*, 70 ECON. J. 496, 498 (1960) (welfare effects of customs union depend upon "relative strengths of the forces causing trade creation and trade diversion"); Lipsey & Lancaster, *supra* note 53, at 14 (same).

63. Two or more countries form a customs union when they abolish tariffs applicable to trade between or among themselves while maintaining tariffs applicable to trade with countries outside the union. See generally C. KINDLEBERGER & P. LINDERT, *supra* note 43, at 172-74.

64. Lipsey & Lancaster, *supra* note 53, at 13. For a very simple graphic model of the creation and diversion effects, see C. KINDLEBERGER & P. LINDERT, *supra* note 43, at 172-74.

whether the formation of a customs union will enhance global welfare.<sup>65</sup> Nevertheless, it is possible to make some generalizations. Given a customs union arrangement that marginally reduces tariffs, a net increase in the volume of trade implies a rise in global welfare.<sup>66</sup> Also, trade diversion is minimal when the difference between the excluded seller's cost and the inside seller's cost is small.<sup>67</sup>

The welfare effects of countertrade compare favorably with those associated with customs unions.<sup>68</sup> This Article demonstrates that countries impose countertrade requirements to overcome market failures and thus permit trade where trade would not otherwise be possible. In this way, countertrade has an effect similar to introducing trade into an autarkic economy. Under such circumstances, trade creation must outweigh trade diversion. In addition, barter-like trade often occurs at market prices;<sup>69</sup> therefore, trade diversion is minimal.<sup>70</sup> Countertrade as a second-best policy is economically efficient.<sup>71</sup>

This notion conflicts with the standard view of countertrade as inflexible, costly, and distortionary. Barter-like trade can *increase* flexibility under conditions of economic distress.<sup>72</sup> The costs associated with

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65. See C. KINDLEBERGER & P. LINDERT, *supra* note 43, at 175 (in customs union context, increase in trade does not determine increase in welfare). See text accompanying *supra* note 56.

66. Lipsey, *supra* note 62, at 505-06.

67. C. KINDLEBERGER & P. LINDERT, *supra* note 43, at 175.

68. The closest analogy is to bilateral clearing arrangements. See R. BANERJI, *supra* note 17, at 96 (weighing trade expansion against trade diversion in India's bilateral clearing relationships). An OECD study tentatively concluded that India's bilateral trade in manufactured goods was purely "additional" (i.e., above and beyond multilateral trade). The study found that some diversion in primary products trade was possible, but any such diversion was not significant. *Id.* at 116-17. Because bilateral clearing arrangements allowed India to open and then maintain direct trade with Eastern Europe, *id.* at 37, it seems clear that in this case, trade-creating effects of countertrade predominated and global welfare increased.

69. Carey & McLean, *supra* note 1, at 452 (some LDCs require that countertrade be transacted at market prices); Comment, *supra* note 2, at 138 (countertrade often transacted at market prices through market channels). See, e.g., Peru: *The Targets are High*, TRADE FIN., Feb. 1988, at 8, 8 [hereinafter *Peru*] (draft agreement to swap external debt for goods contains "anti-dumping clause" requiring that goods be sold at world market prices.)

70. C. KINDLEBERGER & P. LINDERT, *supra* note 43, at 173-74 (trade enhancement varies with, and trade diversion varies inversely to, the price difference between bilateral partners and the world market).

71. Countertrade requirements are only likely to be inefficient when imposed solely for the purpose of restricting trade. See *infra* text accompanying note 161.

72. According to the OECD, "in the context of the macro-economic constraints that characterize economic transactions in most developing countries where distortions are often present in prices, markets and particularly exchange rates, countertrade may be viewed as a practical means of introducing flexibility into an otherwise rigid economic system." OECD (1985), *supra* note 2, at 21.

complexity and restricted supply must be compared "with the expense an indebted developing country would have to incur if it tried instead to follow traditional multilateral trading practices."<sup>73</sup> The very existence of countertrade as an alternative to the multilateral payments system indicates that it has value despite the apparent costliness.<sup>74</sup> Countertrade can benefit both parties to a transaction.<sup>75</sup> Barter-like trading practices can be explained in three ways: as a reaction to prevailing economic imperfections, including illiquidity, uncertainty, and imperfect information; as a consequence of political rigidities; and as central to development strategies. It is not enough to look at why individual entities barter; the effect on third parties must also be examined. This Article now addresses in turn each of these four justifications of countertrade.

a. *Economic Imperfections*

i. *Illiquidity*

The multilateral payments system is premised upon stable, well-calibrated national currencies that are freely convertible to all other currencies. Unfortunately, such perfect liquidity is a goal rather than a reality. Because they bear no relation to world prices, the currencies of nonmarket economies are totally inconvertible.<sup>76</sup> Developing countries' currencies are technically convertible because they are pegged to strong currencies. Most LDC currencies, however, are pegged at an overvalued rate for domestic reasons.<sup>77</sup> These features of the international economy are unlikely to change in the foreseeable future.

The meteoric rise and fall of oil prices, interacting with recession in the industrialized countries and ambitious development programs in the South and East, put tremendous pressure on existing monetary arrangements and helped cause the debt crisis of the 1970s and 1980s.<sup>78</sup> Compounding the crisis, net capital flows to the stricken countries have

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73. *Id.* at 22. Even in "cash" transactions with trading entities in Eastern Europe and the Third World, negotiation costs are notoriously high.

74. Banks, *supra* note 6, at 164. It seems reasonable to assume that economic entities act rationally when they elect to countertrade. *But see supra* text accompanying note 45. When such entities have access to the multilateral payments system but choose instead to countertrade, each side must reap benefits in excess of the added costs associated with countertrade.

75. Lochner, *supra* note 2, at 746.

76. See, e.g., Verrill, *Countertrade and Section 406: Statutory Disruption of Trade*, in INTERFACE TWO: CONFERENCE PROCEEDINGS ON THE LEGAL FRAMEWORK OF EAST-WEST TRADE 337, (D. Wallace & D. Flores eds. 1982).

77. See, e.g., USITC (1985), *supra* note 3, at 43-44.

78. See *id.*

virtually dried up.<sup>79</sup> It is universally acknowledged that the resulting illiquidity has driven private and government entities toward barter.<sup>80</sup> In fact, an OECD study has found that sharp rises in international barter in *all* country groups have taken place during specific periods of global recession and illiquidity.<sup>81</sup> Countertrade "may be a second-best solution in a situation characterized by the presence of such distortions as overvalued currencies and foreign exchange rationing."<sup>82</sup>

In countries where foreign exchange reserves are critically low, countertrade permits marginal transactions.<sup>83</sup> Countertrade also facilitates economic exchange when credit is scarce.<sup>84</sup> The case of Malaysia clearly reflects these pressures.<sup>85</sup> Traditionally, the Malaysian Government insisted on hard currency trade, even with the Eastern Bloc and other LDCs. In 1982, however, Eastern Bloc countries' supplies of foreign exchange dropped, so they imported markedly less from Malaysia.

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79. Carey & McLean, *supra* note 1, at 444. Net lending by commercial banks is near zero and official development assistance is stagnant. *Id.* See also Kilborn, *Baker's Dimming Luster*, N.Y. Times, Apr. 29, 1987, at A1, col. 4 (despite the 1985 "Baker Plan" to encourage lending to developing countries, commercial banks have actually reduced their lending to these countries); Lewis, *A Shift in Third World Funds*, N.Y. Times, Feb. 11, 1988, at D1, col. 3 (developing countries now receiving less in combined aid from World Bank and International Monetary Fund than they are paying in interest and principal on outstanding debt to those institutions). For an innovative use of countertrade to reduce outstanding debt, see *Peru*, *supra* note 69 (Peruvian government program to swap nontraditional exports for international commercial bank debt).

80. See, e.g., OECD (1985), *supra* note 2, at 14-16; USITC (1985), *supra* note 3, at 38; Verdun, *supra* note 2, at 196; Carey & McLean, *supra* note 1, at 444; Parry, *GATT Weighs the Evidence of Discrimination in the Growing Practice of Global Bartering*, AM. BANKER, Sept. 21, 1984, at 39, col. 2 (analysis by GATT experts); Verrill, *supra* note 76, at 337.

81. I. OUTTERS-JAEGER, *supra* note 1, at 14-15.

82. OECD (1985), *supra* note 2, at 21.

83. Inconvertibility means that trade must be financed with "hard" currency reserves, which are scarce. Governments therefore must allocate foreign exchange. Countertrade eases the burden on the allocation system. See, e.g., USITC (1985), *supra* note 3, at 42 (countertrade "allowed the stretching of funds available for trade financing"); OECD (1985), *supra* note 2, at 22. These transactions actually approximate open market deals more closely than cash transactions where local currencies are overvalued. See BUSINESS INT'L CORP., *supra* note 2, at 27 (selective devaluation); OECD (1985), *supra* note 2, at 16, 21; USITC (1985), *supra* note 3, at 42. In fact, under these circumstances, countertrade may *improve* a nation's trade balance position, because imported capital goods may have a higher value in terms of domestically available resources than the international cash price. *Id.* at 42 n.1.

84. Countertrade is a means of finance. E.g., Lochner, *supra* note 2, at 728. Countertrade transactions in general allow banks to bypass country credit evaluations, which are necessarily very unfavorable in crisis situations. BUSINESS INT'L CORP., *supra* note 2, at 22. Counterpurchasing allows risk to be borne by a trading house rather than an Eastern or Southern entity. *Id.* at 22, 27; USITC (1985), *supra* note 3, at 43. Buybacks allow long-term credit which would otherwise not be given in such large deals between the East and West. Lowenfeld, *supra* note 60, at 330.

85. See Schwenk, *supra* note 20, at 102-03.

Simultaneously, the terms-of-trade for Malaysian exports turned unfavorable, and external reserves fell so low that only ten months of imports could be financed. In desperation, the Malaysian Government began to encourage countertrade.<sup>86</sup> Thus, countertrade can enhance trade because "many countries cannot operate in a monetary system. The price of the countertrade transaction can be viewed as the cost of borrowing money for the transaction."<sup>87</sup>

## ii. *Uncertainty*

Many factors have conspired in the 1970s and 1980s to create extreme instability in international markets. The resulting uncertainty has created costs for economic actors. Countertrade may provide the least expensive hedge against instability.<sup>88</sup> Barter-like trade has protected against inflation,<sup>89</sup> dampened the effect of exchange rate swings,<sup>90</sup> and stabilized LDC trade.<sup>91</sup> Industrialized countries have also engaged in countertrade to ensure stable supplies of strategic commodities.<sup>92</sup>

## iii. *Imperfect Information*

Marketing primary products usually does not create problems. However, Eastern European and less developed countries increasingly seek to export "nontraditional" products for which markets or lines of distribution have yet to be established. Countertrade may be used to introduce exports directly into new markets,<sup>93</sup> or to "piggyback" on the

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86. *Id.* Opponents of countertrade often point to Indonesia's difficulties with its mandatory program. "One must recognize, however, that it was enacted in response to a rapidly deteriorating economic situation." *Id.* at 102. It is expected that Indonesia will repeal or revise its countertrade program when its economy improves. *Id.*

87. Carey & McLean, *supra* note 1, at 450 (quoting a businessperson).

88. See OECD (1985), *supra* note 2, at 21.

89. Analysis of Recent Trends in U.S. Countertrade, USITC Pub. 1237, Inv. No. 332-125, at 10 (1981) [hereinafter USITC (1981)].

90. Carey & McLean, *supra* note 1, at 444; Lochner, *supra* note 2, at 736.

91. An OECD quantitative study of five countries indicates that bilateral clearing arrangements "had a stabilising effect on total trade." I. OUTTERS-JAEGER, *supra* note 1, at 84-86. Countertrade helps to address fluctuations in export earnings caused by cyclical movements in commodity prices. OECD (1985), *supra* note 2, at 16, 18; I. OUTTERS-JAEGER, *supra* note 1, at 84 (fluctuations are a major concern in the Third World, where economies depend on restricted range of exports); Lochner, *supra* note 2, at 736. Reciprocity can ensure stability of imports as well. L. WELT, *supra* note 11, at 65-66.

92. See *supra* note 34.

93. Bilateral barter-like trade has been "instrumental" in promoting exports of minor traditional and new industrial goods. I. OUTTERS-JAEGER, *supra* note 1, at 60. See OECD (1985), *supra* note 2, at 18. In the 1960s, India's State Trading Corporation used barter to introduce gunny sacks to Switzerland, typewriters to France, and carpets to Sweden. R. BANERJI, *supra* note 17, at 36.

marketing capabilities of multinational corporations.<sup>94</sup> For instance, Yugoslavia once bought seven airplanes from McDonnell Douglas Corporation. In return, McDonnell Douglas accepted some cash, and agreed to act as broker for nine million dollars in Yugoslav goods new to the American market (and purchased forty thousand dollars in hams for its cafeterias).<sup>95</sup> As a marketing tool, countertrade helps to disseminate commercial information which otherwise would be unavailable.

### b. *Political Rigidities*

Political rigidities also impose constraints on the free trade ideal. Ideology, economic planning, and the bureaucratic matrix of foreign trade in Eastern and Southern countries provide a strong impetus to reciprocal trading.<sup>96</sup> Because this matrix is ideologically based, it is unlikely to change and must be accepted as an exogenous factor.<sup>97</sup> Countertrade also facilitates trade that would otherwise be impossible because of political antipathy;<sup>98</sup> it can even ease political tensions.<sup>99</sup>

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94. USITC (1981), *supra* note 89, at 5 (Eastern European countries); Yoffie, *Profiting from Countertrade*, HARV. BUS. REV., May-June 1984, at 8, 9. Critics of countertrade raise two problems with this marketing rationale. First, in commodity markets, countertraded goods may simply displace existing sales. *See, e.g.*, OECD (1985), *supra* note 2, at 24. However, this kind of trade diversion is not yet significant in volume. *Id.* at 26. Second, shunting off marketing upon multinational corporations may preclude development of independent distribution channels. *See, e.g., id.* at 24; Banks, *supra* note 6, at 166-68. To be fair, though, "cash" transactions have so far not created independent channels either. Countertrade actually may encourage nonmarket economies to react to marketing information. USITC (1985), *supra* note 3, at 2 (evidence accounts cause MNCs to assist foreign party in redesigning or developing marketable products).

95. Weigand, *International Trade Without Money*, HARV. BUS. REV., Nov.-Dec. 1977, at 28, 28-29.

96. *See generally* Banks, *supra* note 6, at 172-74. *See also* de Miramon, *supra* note 2, at 14-15. First, Eastern Bloc countries are very reluctant to enmesh themselves in world capitalism. Second, countertrade harmonizes foreign trade with central planning. As a balancing device, countertrade offers planners both stability and predictability. Third, the ultimate goal of plan fulfillment guarantees that foreign trade plays a peripheral role in Eastern economic organization. Essentially, foreign trade organizations use countertrade to dispose of surplus items and to acquire necessary imports. *Perestroika*, the package of Soviet economic reforms, aims to streamline the foreign trade bureaucracy but does not strike at the underpinnings of countertrade. *See generally* Barrett, *How the West Could Win for Gorbachev*, EUROMONEY, Sept. 1987, at 473. In fact, liberalization of the strict entity-by-entity quota system may encourage countertrade by increasing the range of products an Eastern trader can offer as counterpurchases. *Comecon Through 1989*, BUS. INT'L, Dec. 7, 1987, at 388-89. These same factors, to a lesser extent, encourage countertrade in developing countries with large public sectors.

97. Countertrade has been criticized because it delays economic reforms, particularly in non-market economies. *See, e.g.,* de Miramon, *supra* note 46, at 351. It is not clear, however, that nonbarter trade is more consistent with reform. *Cf. supra* note 95.

98. Sometimes, routine sales are politically impossible, as was the case between Pakistan



Countertrade serves as a proxy for "investment" where views of capitalism and sovereignty discourage equity participation by multinational corporations.<sup>100</sup> Finally, barter-like trade can counteract anticompetitive government practices.<sup>101</sup>

### c. Countertrade and Development

Much of the foregoing analysis makes countertrade an attractive development tool for Eastern European countries<sup>102</sup> and LDCs.<sup>103</sup> Because a multinational corporation has an ongoing interest in the output of an industrial compensation project, the recipient countries are assured of appropriate and dynamic technologies.<sup>104</sup> Bilateral clearing arrangements have allowed developing countries to diversify away from ex-colonial powers, open new sources of development assistance,<sup>105</sup> and foster regional integration.<sup>106</sup> Less developed countries may even improve their terms of trade via barter,<sup>107</sup> casting doubt on the thesis that ordinary cash transactions are more efficient than countertrade.

By definition, developing countries (whether in the Third World or

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and Bangladesh—the former East Pakistan. Although the two economies had substantial complementarity, political antipathy ruled out use of hard currency or credit. The two countries ended up simultaneously bartering equal values of jute and cotton. Weigand, *supra* note 95, at 29.

99. Comment, *supra* note 2, at 149-50.

100. See Guyot, *supra* note 8, at 921. See also Lochner, *supra* note 2, at 746; de Miramon, *supra* note 46, at 348. Countertrade "acts as an interface, and facilitates a greater degree of economic interchange." Lochner, *supra* note 2, at 746.

101. Barter allowed traders to contract around the OPEC cartel price for oil, attaining a price nearer the hypothetical competitive equilibrium. See, e.g., L. WELT, *supra* note 11, at 65-66. Countertrade also may allow Eastern and Southern traders to get around Western non-tariff barriers. de Miramon, *supra* note 46, at 348; Comment, *supra* note 46, at 348; Comment, *supra* note 2, at 133, 149. *Contra* OECD (1985), *supra* note 2, at 17.

102. Verrill, *supra* note 76, at 337.

103. Carey & McLean, *supra* note 1, at 454-55.

104. USITC (1981), *supra* note 90, at 5 (Eastern European countries); BUSINESS INT'L CORP., *supra* note 2, at 30 (LDCs).

105. I. OUTTERS-JAEGER, *supra* note 1, at 60-61, 120-21. For instance, Yugoslavia used barter to help Pakistan install wells; Yugoslavia contributed equipment, construction assistance, and technology, and received partial payment in raw jute. *Id.* at 49-50.

106. For example, the Latin American Integration Association facilitates bilateral arrangements to encourage regional development. Carey & McLean, *supra* note 1, at 432.

107. If barter trade directly between East and South reduces transaction costs by eliminating Western middlemen, both East and South would be better off. Likewise, more favorable terms-of-trade would result if countertrade, in comparison with multilateral trade, allows East and South to realize greater complementarity of consumption and production. An OECD study found that developing countries' terms-of-trade with the nonmarket economies were generally not worse, and in some cases better, than terms in the multilateral system. I. OUTTERS-JAEGER, *supra* note 1, at 109.

Eastern Europe) are not well integrated into the world economy. Market failures and political rigidities are more common and more pressing in the economic affairs of these countries.<sup>108</sup> Hence, countertrade addresses a wide range of deeply felt needs in the developing world.<sup>109</sup>

d. *Effect on Third Parties and World Trade*

Traders achieve real benefits through countertrade since they are able to overcome barriers to trade. Between the immediate trading parties, countertrade can provide a second-best solution to market failures and political distortions. However, the countertrading parties do not capture all the benefits of their actions; the benefits of increased trade spill over to third parties. New resources are tapped, new markets are opened, and beleaguered economies are saved from collapse. Countertrade may indeed be a second-best solution from the standpoint of the world economy.

It is true that countertrade has costs as well as benefits. When compared with the realities of "cash" trade, however, countertrade does not seem so expensive.<sup>110</sup> Furthermore, any residual costs of countertrade do not spill over in the same manner as the benefits. Since traders can choose to utilize the multilateral payments system, the transaction costs associated with countertrade cannot be passed along to third parties.<sup>111</sup> "The costs to the world economy of countertrade . . . are thus relatively small and are borne principally by the countries imposing them."<sup>112</sup> Where countertrade is costly and therefore trade-distorting, it is also likely to be self-correcting.

In addition, the existence of countertrade need not threaten the multilateral payments system; countertrade may be viewed as supplementary.<sup>113</sup> World trade is not perfectly continuous, but countertrade helps

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108. One commentator has observed:

[A]lthough there may be short-term policy considerations which lead a government to adopt countertrade requirements, such practices are economically inefficient and, in the long-run, ultimately restrict rather than expand trade.

Verdun, *supra* note 2, at 201 (footnote omitted). Even if this is true, "[p]oor countries that have no foreign exchange cannot take a long-run view of international trade." Weigand, *supra* note 95, at 42.

109. Of course, countertrade can also aid traders in developed countries in overcoming market imperfections. See, e.g., *supra* text accompanying note 26 ("reverse" countertrade).

110. See *supra* note 73.

111. OECD (1985), *supra* note 2, at 25. In addition, countertrade is often transacted at market prices through market channels. Comment, *supra* note 2, at 138. See *supra* note 69 and accompanying text.

112. Banks, *supra* note 6, at 178.

113. Carey & McLean, *supra* note 1, at 452 (view of Latin American governments).

to provide the interface between segments of the global economy that are separated by market failure, ideology, or political antipathy. Far from threatening to displace the GATT as a parallel bilateral system, barter-like trade remains "largely ad hoc in nature."<sup>114</sup>

#### IV. COUNTERTRADE AND THE LAW OF THE GATT

The General Agreement on Tariffs and Trade is both a detailed set of legal rules<sup>115</sup> and an international organization charged with overseeing the operation of those rules.<sup>116</sup> This section offers a defense of countertrade, under GATT's rules, when used as a second-best policy. Part V then explores the institutional ramifications of countertrade for the GATT. The ultimate goal of the General Agreement is to enhance global economic welfare.<sup>117</sup> To this end, the GATT was designed to increase world trade and allocate resources efficiently.<sup>118</sup>

Countertrade has been criticized repeatedly as incompatible with the goals of the GATT<sup>119</sup> and as contravening specific GATT provisions.<sup>120</sup>

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114. Schwenk, *supra* note 20, at 96. See Lochner, *supra* note 2, at 729.

115. The GATT is in reality a series of more than one hundred agreements. J. JACKSON & W. DAVEY, *LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS* 296 (2d ed. 1986).

116. *Id.* at 293-96.

117. See J. JACKSON, *WORLD TRADE AND THE LAW OF GATT* § 2.6 (1969); Czinkota & Talbot, *GATT Regulation of Countertrade: Issues and Prospects*, 1 *INT'L TRADE J.* 155, 156 (1986).

118. J. JACKSON, *supra* note 117, § 1.1; Czinkota & Talbot, *supra* note 117, at 156. The GATT seeks economic efficiency through four central principles: open markets, *see* GATT, *supra* note 5, arts. II (tariff concessions) & XI (elimination of quantitative restrictions); non-discrimination, *see id.* arts. I (most favored nation treatment) & III (national treatment); reciprocity, *see id.* art. I; and transparency, *see id.* art. X (publication and administration of trade regulations).

119. See, e.g., Czinkota & Talbot, *supra* note 117, at 157-59; Gadbaw, *The Implications of Countertrade under the General Agreement on Tariffs and Trade*, 5 *J. COMP. BUS. & CAPITAL MARKETS L.* 355, 355 (1983) ("fundamental incompatibility between countertrade practices and the framework of trade envisioned by the GATT drafters"). Note, however, that a "contradiction of the spirit of the accord is insufficient cause for the GATT to take any kind of action." Czinkota & Talbot, *supra* note 117, at 159.

120. See Czinkota & Talbot, *supra* note 117 (highlighting GATT articles most likely to be violated by countertrade); Roessler, *Countertrade and the GATT Legal System*, 19 *J. WORLD TRADE L.* 20 (1985) (same); Verdun, *supra* note 2, at 211-13 (arguing that countertrade requirements constitute quantitative restrictions under article XI); Liebman, *Comment: GATT and Countertrade Requirements*, 18 *J. WORLD TRADE L.* 252 (1984) (reviewing arguments that countertrade requirements of Eastern countries violate various provisions of GATT); Baker & Cunningham, *Countertrade and the Law*, 5 *J. COMP. BUS. & CAPITAL MARKETS L.* 375 (1983) (same); Gadbaw, *supra* note 119 (arguing that countertrade violates several GATT provisions); Comment, *supra* note 60 (analyzing countertrade under several GATT articles, with special attention to developing countries).

It is clear that application of GATT rules requires careful consideration of GATT goals.<sup>121</sup> Because GATT legal problems cannot be analyzed without reference to economic facts and goals,<sup>122</sup> however, these views are severely compromised by adherence to the general equilibrium critique of countertrade.

Under conditions of market failure, the parallel GATT objectives of increased trade and allocative efficiency may conflict. As a second-best solution, countertrade's trade-enhancing effects far outweigh its trade-distorting effects. Therefore, countertrade may be consistent with the ultimate GATT goal of global economic welfare.

Furthermore, the GATT itself may be read as a second-best system of rules in two important respects. First, the GATT represents a second-best political solution. The General Agreement was never meant to be comprehensive; rather, it was to function as a component of the International Trade Organization.<sup>123</sup> When the United States Congress effectively killed the International Trade Organization in 1950 by refusing to ratify its charter, the GATT remained, though "ill-adapted to perform the role that had been thrust upon it."<sup>124</sup> Hence, from its inception, the General Agreement has failed to address problems of nonmarket economies, less developed countries, employment, foreign investment, and economic development in a satisfying manner.<sup>125</sup> This remains a problem today:

One of the challenges of the near future, is how the elaborate GATT system, which was designed primarily for market economies of mostly advanced industries, can accomodate the special problems of either nonmarket economies, or developing countries.<sup>126</sup>

In fact, the GATT has never officially come into force; it has always rested on nothing more sound than a Protocol of Provisional Application.<sup>127</sup> Second, the GATT recognizes that "first-best" economic out-

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121. J. JACKSON, *supra* note 117, § 2.6; Comment, *supra* note 60, at 317.

122. J. JACKSON, *supra* note 117, § 1.1.

123. See K. KOCK, INTERNATIONAL TRADE POLICY AND THE GATT 1947-1967, at 69-70 (1969).

124. J. JACKSON & W. DAVEY, *supra* note 115, at 295-96.

125. See, e.g., J. JACKSON, *supra* note 117, § 20.1; K. KOCK, *supra* note 123, at 66-67.

126. J. JACKSON & W. DAVEY, *supra* note 115, at 6. *Accord G. WINHAM, INTERNATIONAL TRADE AND THE TOKYO ROUND NEGOTIATIONS* 375 (1966). See *id.* at 376 (Tokyo Round not successful at bridging North-South gap; developing countries frozen out of negotiations, development needs not addressed); K. KOCK, *supra* note 123, at 264 (dissatisfaction of Southern and Eastern countries with GATT led to creation of United Nations Conference on Trade and Development (UNCTAD)).

127. Oct. 30, 1947, 61 Stat. pts. 5-6, T.I.A.S. No. 1700, 55 U.N.T.S. 308.

comes are not always attainable. For example, the General Agreement endorses trade restrictions to safeguard the national balance of payments,<sup>128</sup> to protect domestic industries in emergencies,<sup>129</sup> and to protect national security.<sup>130</sup>

Countertrade may complement and supplement the existing legal framework of international trade. The second-best nature of countertrade has implications regarding the applicability of current GATT rules.

### A. Applying GATT Rules to Countertrade

There is no reference whatsoever to countertrade in the General Agreement, and no contracting party has ever raised the issue before a GATT dispute-resolution panel.<sup>131</sup> Further, it seems settled that countertrade does not constitute a per se violation of the GATT.<sup>132</sup> Under certain circumstances, however, it is possible that a particular countertrade transaction may be inconsistent with a GATT obligation. Some commentators have suggested that GATT provisions should be interpreted broadly to proscribe countertrade transactions.<sup>133</sup> This is misleading because of the delicate consensual basis of the GATT.<sup>134</sup> The restrictive provisions of the General Agreement are strictly construed.<sup>135</sup>

It must also be borne in mind that the GATT does not reach all countertrade transactions. First, the GATT does not cover military trade, so it cannot limit most offset trading.<sup>136</sup> Second, only contracting parties incur GATT obligations.<sup>137</sup> Third, the GATT governs government action and not private decisions; GATT provisions are only rele-

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128. GATT, *supra* note 5, art. XII.

129. *Id.* art. XIX.

130. *Id.* art. XXI.

131. OECD (1985), *supra* note 2, at 11.

132. USITC (1985), *supra* note 3, at 120 app. H (general view). See also BUSINESS INT'L CORP., *supra* note 2, at 34-35 (position of GATT secretariat); Parry, *supra* note 80, at 40 (same).

133. See Verdun, *supra* note 2, at 207 (interpretation of Article XI on quantitative restrictions); Parry, *supra* note 80, at 40.

134. See G. WINHAM, *supra* note 126, at 20.

135. Liebman, *supra* note 120, at 260. See Czinkote & Talbot, *supra* note 117, at 159. For a general discussion of GATT interpretation, see J. JACKSON, *supra* note 117, § 1.5.

136. See, e.g., USITC (1985), *supra* note 3, at 120 app. H. It must be noted that military hardware accounts for a relatively large portion of barter trade. Watson, *supra* note 2, at 37, 39.

137. For a list of the ninety contracting parties and thirty-one countries applying the GATT on a de facto basis, see J. JACKSON & W. DAVEY, *supra* note 115, at 312 (as of Feb. 1985). Only six nonmarket economies are GATT members: Cuba, Czechoslovakia, Hungary, Poland, Romania, and Yugoslavia. Substantially fewer countries have signed the Multilateral Trade Negotiating codes. See *id.* at 330.

vant when violated by an official "requirement or inducement to engage in countertrade."<sup>138</sup> Most writers therefore focus on "mandated" countertrade.<sup>139</sup>

This Article will proceed by analyzing countertrade as a second-best policy under each relevant provision of the General Agreement on Tariffs and Trade. The GATT goal of open trade finds expression as a broad prohibition against quantitative restriction. First, this Article will take up the contention most strenuously urged by commentators—that countertrade constitutes a quantitative restriction. Addressed second will be the less categorical twin nondiscrimination principles: most favored nation treatment and national treatment. Third, this Article will explore the subsidies obligations of the General Agreement, and fourth, the Article will review miscellaneous provisions of the GATT. Finally, the Article will examine countertrade's role in the application of GATT rules to nonmarket economies and less developed countries.

## 1. Quantitative Restrictions

To render tariff reductions meaningful, the GATT comprehensively regulates the use of quantitative restrictions.<sup>140</sup> Article XI states the general rule prohibiting quantitative restrictions:

No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party.<sup>141</sup>

The apparent breadth of this proscription has prompted commentators to declare that countertrade is inconsistent with the GATT.<sup>142</sup> "If import licenses are granted on the condition that the imports are linked to exports," the argument runs, "trading opportunities are restricted

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138. Parry, *supra* note 80, at 40. *Accord* Czinkota & Talbot, *supra* note 117, at 157.

139. See, e.g., Walsh, *supra* note 27. The term "mandated countertrade" is extremely confusing. Often, it refers to countries that require bilateralism in substantially all trade transactions. Only two countries, Indonesia and Romania, mandate countertrade in this way. See, e.g., Lochner, *supra* note 2, at 739.

140. GATT, *supra* note 5, art. XI(1). Articles XI(2), XII, XIV, and XVIII part B provide for exceptions to this rule. Article XIII regulates existing and permitted quantitative restrictions.

141. GATT, *supra* note 5, art. XI(1). Article XI reaches restrictions "made effective through state-trading operations." *Id.* annex 1 (arts. XI, XII, XIII, XIV, and XVIII).

142. See, e.g., Verdun, *supra* note 2, at 192.

through a method other than duties, taxes or charges."<sup>143</sup> However, this argument is not supported by a close reading of the language of article XI, the intended scope of its prohibition, or the spirit of the General Agreement.

The characterization of countertrade as a quantitative restriction rests on the proposition that *any* government action which operates to restrict trade in *any* way violates article XI.<sup>144</sup> Such a reading would obviate other articles of the GATT, such as the subsidies provisions of article XVI.<sup>145</sup> Article XI proscribes quantitative restrictions, and countertrade does not restrict imports by quantity.<sup>146</sup>

The primary target of article XI has always been quotas.<sup>147</sup> Countertrade does not involve explicit quotas.<sup>148</sup> Therefore, the applicability of the GATT prohibition of quantitative restrictions depends upon whether countertrade operates like a quota.<sup>149</sup>

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143. Roessler, *supra* note 120, at 605. *Accord Verdun*, *supra* note 2, at 211-12 ("countertrade requirements impose quid pro quo conditions that restrict trade"); Comment, *supra* note 60, at 326.

144. Gadbaw, *supra* note 119, at 361; *see also* Liebman, *supra* note 120, at 254 (countertrade violates GATT because it limits imports).

145. GATT, *supra* note 5, art. XVI(1) (regulating use of subsidies to reduce imports).

146. *Contra* Liebman, *supra* note 120, at 254; Gadbaw, *supra* note 119, at 361; Comment, *supra* note 60, at 327. Countertrade is contingent upon the value of goods and services taken out of a country. If a trader wishes to raise its exports to a country that mandates countertrade, it must accept more exports from that country. Industrial compensation arrangements have nothing to do with the quantitative restriction of imported goods. In the typical buyback transaction, a multinational corporation sets up a manufacturing facility in the host country and then takes a defined quantity of the manufactured product in payment. *See supra* text accompanying notes 29-34. Commercial compensation policies may limit a country's imports of a product to a fixed percentage of the value of specific exported products; this is the counterpurchase ratio. *See supra* text accompanying note 22. However, the country's countertrade partner decides how much of the specified products to purchase. Therefore, the *partner* determines the level of imports into the country.

If a government adopts a countertrade policy for the purpose of setting a quantitative restriction on imports, that policy would certainly come within the article XI prohibition. It has been shown, though, that many other reasons motivate countertrade policies. *See supra* Part III.

The General Agreement has always recognized that quantitative restrictions are distinguishable from other types of restrictions. For example, during the drafting of article XI, the United States took the following position: "Of all the forms of restrictionism ever devised by the mind of man, Quantitative Restriction is the worst." J. JACKSON, *supra* note 117, § 13.2 (footnote omitted) (quoting U.N. Doc. EPCT/A/P.V.22 (1947)).

147. *See Verdun*, *supra* note 2, at 205. At the drafting conferences involving quantitative restrictions, the participants debated the evils of quotas. *See* J. JACKSON, *supra* note 117, § 13.2. Professor Jackson defines quantitative restrictions as quotas, *id.* § 13.1, then proceeds to equate the two ideas throughout his discussion, *id.* ch. 13.

148. *See Verdun*, *supra* note 2, at 206.

149. Where the degree of consensus on a provision of the GATT is low, the provision will be read narrowly. *See supra* notes 134-135 and accompanying text. The preparatory work for

A quota is a government decree that during a given period, only a specific amount of a product may be imported.<sup>150</sup> Tariffs and quotas affect international trade in very different ways:

In the case of a tariff the total volume of imports can expand with the expansion of trade. There is flexibility in the volume of trade. Under a quota system the volume of trade is rigidly restricted, and no matter how much more people may wish to buy or consume, not one single more unit will be admitted than the controlling authority thinks

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the quantitative restrictions articles reflected "major policy clashes." J. JACKSON, *supra* note 117, § 13.2. Article XI was adopted only after a "struggle," and the less-developed countries were very displeased with the results. *Id.* The LDCs as a group have opposed these provisions. J. JACKSON & W. DAVEY, *supra* note 115, at 367. Further, developed countries have negotiated devices such as voluntary export restraints and orderly marketing arrangements that resemble quotas much more closely than does countertrade. See generally *id.* at 608-22.

Still, as Professor Verdun has argued, Article XI may apply to quantitative restrictions that are not quotas. Verdun, *supra* note 2, at 211. She cites three recent article XI disputes in support of this proposition. *Id.* at 208-11. See *EEC—Quantitative Restrictions Against Imports of Certain Products from Hong Kong*, BISD, *supra* note 5, 30th Supp., at 129 (1984); *Canada—Administration of the Foreign Investment Review Act*, BISD, *supra* note 5, 30th Supp., at 140 [hereinafter *Canadian FIRA*]; *United States—Imports of Certain Automotive Spring Assemblies*, BISD, *supra* note 5, 30th Supp., at 107.

In *Products from Hong Kong*, the United Kingdom (on behalf of Hong Kong) sought relief from French quantitative restrictions on eight product categories. France maintained import quotas for five of these categories; the remaining three were subject to a de facto quota administered under special regulations. BISD, *supra* note 5, 30th Supp. at 129-31. The GATT panel found that France infringed its article XI obligations for all eight categories of products. *Id.* at 140. Thus, article XI proscribes certain quantitative import restrictions that closely resemble quotas.

In *Canadian FIRA*, the United States challenged application of a Canadian law designed to ensure that investment projects would provide "significant benefit to Canada." *Canadian FIRA*, *supra*, at 142. Under FIRA, foreign investors routinely negotiated undertakings with the Canadian government. *Id.* at 143. Some of these undertakings committed the investors "to purchase goods of Canadian origin in preference to imported goods or in specified amounts or proportions." *Id.* at 146. "[T]he Panel, noting that purchase undertakings do not prevent the importation of goods as such, reached the conclusion that they are not inconsistent with Article XI:1." *Id.* at 163.

*Spring Assemblies* involved a U.S. International Trade Commission exclusion order directed against imported products that violated a United States patent. BISD, *supra* note 5, 30th Supp., at 107. Canada complained that the order violated article XI. *Id.* at 119-20. The GATT panel found that the exclusion order came within an article XX exception; therefore, it did not reach a conclusion with respect to Article XI. *Id.* at 126-27.

These three panel reports stand for the proposition that article XI may apply to quantitative restrictions other than quotas, but only if the restrictions closely resemble quotas. Professor Verdun reads the cases much more broadly, apparently because she finds it "noteworthy" that parties in *Canadian FIRA* and *Spring Assemblies* have challenged "practice[s] which did not involve quotas." Verdun, *supra* note 2, at 210. The panel reports, however, simply do not support her conclusion that "countertrade requirements clearly constitute violations of the GATT." *Id.* at 213. See also *supra* note 132 and accompanying text (countertrade is not a per se violation of GATT rules).

150. J. JACKSON, *supra* note 117, § 13.1.



fit.<sup>151</sup>

Quotas "completely break any link between domestic and world prices."<sup>152</sup> Countertrade does not operate like a quota:<sup>153</sup> it allows the volume of imports to expand with the expansion of trade, it introduces flexibility,<sup>154</sup> and it does not break the link between world and domestic prices.<sup>155</sup> Article XI was never intended to regulate measures like countertrade requirements.

In order to interpret the article XI prohibition of quantitative restrictions, it is necessary to look to the spirit of the GATT.<sup>156</sup> The GATT frowns on quotas in part because they embody political intervention and interrupt the flow of goods in response to cash price.<sup>157</sup> It is clear that quantitative restrictions were prohibited by GATT because they were considered to be incompatible with the expansion of world trade.<sup>158</sup> Commentators who believe that countertrade contravenes the quantitative restrictions articles therefore state that, like quotas, countertrade restricts trade.<sup>159</sup> They fail to appreciate the trade-enhancing qualities of countertrade. Government intervention to overcome economic and political rigidities can increase world trade.<sup>160</sup> When it overcomes market failures, countertrade departs from ordinary cash transactions in a manner consistent with the spirit of the GATT. Unless intended specifically to protect domestic products, countertrade does not constitute a quantitative restriction.

Moreover, even if a particular instance of countertrade constitutes a quantitative restriction within the meaning of article XI, it may still fall within the GATT exceptions for measures that address balance-of-payments difficulties.<sup>161</sup> Countertrade is largely consistent with the spirit of

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151. *Id.* § 13.2 (quoting U.N. Doc. EPCT/A/P.V.22 (1947)) (U.S. position).

152. Bell, *Analysis of Alternative Protective Measures*, in UNITED STATES COMMISSION ON INTERNATIONAL TRADE AND INVESTMENT POLICY, PAPERS I (1971), excerpted in J. JACKSON & W. DAVEY, *supra* note 115, at 421.

153. *But see* Liebman, *supra* note 120, at 254 (countertrade is a de facto quota).

154. *See supra* text accompanying note 72.

155. *See supra* note 69 and accompanying text.

156. Comment, *supra* note 60, at 326 n.92. *See also* Verdun, *supra* note 2, at 192, 207 (article XI must be interpreted in light of economic circumstances and reality of international practices).

157. Verdun, *supra* note 2, at 213; *see also* J. JACKSON, *supra* note 117, § 13.2.

158. Comment, *supra* note 60, at 327.

159. *See, e.g.,* Verdun, *supra* note 2, at 212-13.

160. *See supra* text accompanying notes 60-61.

161. *See* Liebman, *supra* note 120, at 259; Comment, *supra* note 60, at 327-34. *But see* Verdun, *supra* note 2, at 206 n.85. Article XII provides that "any contracting party, in order to safeguard its external financial position and its balance of payments, may restrict the quantity or value of merchandise permitted to be imported." GATT, *supra* note 5, art. XII(1). *See*

the GATT balance-of-payments safeguards. Acute balance-of-payments problems are a primary factor motivating countertrade.<sup>162</sup> Furthermore, article XII recognizes that "widespread application" of quantitative restrictions may indicate "the existence of a general disequilibrium which is restricting international trade."<sup>163</sup> Thus, "when countertrade is used as a way of producing a reasonable trade balance with the West, which seems to be a primary *raison d'être*, the GATT offers few grounds for attack."<sup>164</sup>

## 2. Nondiscrimination

The General Agreement strives not only to decrease barriers obstructing international flows, but also to ensure that trade is conducted on a nondiscriminatory basis. The most favored nation (MFN) principle bars discrimination among the products of different contracting parties; the national treatment principle prohibits discrimination between foreign and domestic products. Special problems also arise with respect to state-trading enterprises. Because countertrade has been assailed as "inherently discriminatory,"<sup>165</sup> these GATT norms must be explored.

### a. *The Most Favored Nation Principle*

Central to the General Agreement is the unconditional most favored nation principle contained in article I:<sup>166</sup>

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generally J. JACKSON, *supra* note 117, § 26.3. Such restrictions, however, may only be employed to the extent necessary to address critically low monetary reserves. GATT, *supra* note 5, art. XII(2). See also *id.* art. XII(3)(a) (contracting parties must choose restrictions that restore balance-of-payments equilibrium, minimize economic distortion, and "expand rather than contract international trade"); *id.* art. XII(4) (party applying restrictions must consult with other contracting parties). Article XVIII, section B, offers a similar but more forgiving safeguard to developing countries. See J. JACKSON, *supra* note 117, § 26.4.

162. See GATT, *supra* note 5, art. XII(1); *id.* art. XVIII(9); *supra* text accompanying notes 78-80; *supra* text accompanying notes 85-86 (Malaysia resorted to countertrade when foreign exchange reserves plummeted). See also GATT, *supra* note 5, art. XII(3)(a) (parties should adopt measures which expand world trade); *supra* note 60 and accompanying text (countertrade allows trade which would otherwise be impossible). Cf. J. JACKSON, *supra* note 117, § 26.3 (summarizing rules for using balance-of-payments restrictions).

163. GATT *supra* note 5, art. XII(5) (contracting parties must discuss "[measures] to remove the underlying causes of the disequilibrium"). Since 1955, the contracting parties have "recognized that for [LDCs] balance-of-payments difficulties will tend to be generated by development itself." *Reports Relating to the Review of the Agreement: Quantitative Restrictions*, BISD, *supra* note 5, 3d Supp., at 183 (1955).

164. Baker & Cunningham, *supra* note 120, at 378. But see *Declaration on Trade Measures Taken for Balance-of-Payments Purposes*, BISD, *supra* note 5, 26th Supp., at 205 (1980) (attempting to narrow scope of balance-of-payments safeguards).

165. *E.g.*, Comment, *supra* note 60, at 314-16.

166. J. JACKSON & W. DAVEY, *supra* note 115, at 428. Many other MFN clauses are

With respect to . . . all rules and formalities in connection with importation and exportation . . . any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.<sup>167</sup>

In essence, the MFN principle requires contracting parties to globalize all bilateral trade preferences.

Article I draws upon a long history of most favored nation clauses.<sup>168</sup> Nevertheless, the unconditional MFN obligation is exceedingly difficult to interpret.<sup>169</sup> One thing does seem clear: countertrade, when applied equally to all contracting parties, does not violate article I.<sup>170</sup> Most explicit countertrade programs are facially nondiscriminatory. Still, it is conceivable that discriminatory operation of countertrade requirements could be considered a violation of the MFN principle.<sup>171</sup> There is little indication, however, of any such *de facto* discrimination.<sup>172</sup> Countertrade policies tend to make distinctions among goods and not countries. Distinctions among goods are permissible under article I.<sup>173</sup>

Bilateral clearing arrangements require separate analysis. Because a country might have such arrangements with some trading partners but

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scattered throughout the GATT. J. JACKSON, *supra* note 117, § 11.3 (listing MFN provisions).

167. GATT, *supra* note 5, art. I(1).

168. J. JACKSON, *supra* note 117, § 11.1.

169. *Id.* § 11.3.

170. Gadbow, *supra* note 119, at 359 ("A strict reading of the language of Article I supports the view that a countertrade requirement applying equally to all foreign countries would not be inconsistent with [the MFN principle] because all foreign countries are subject to the same requirement."). Accord Liebman, *supra* note 120, at 253. See Comment, *supra* note 60, at 319. It is possible to go further. Unless a new trade policy confers "any advantage, favor, privilege or immunity," it can be argued, the policy cannot contravene article I. Countertrade programs impose burdens, not benefits. Professor Roessler, a Counsellor in the Legal Office of the GATT secretariat, seems to have adopted this reasoning; he states only that "[a] tariff advantage conditional upon the fulfilment [sic] of countertrade requirements that is not made available to all contracting parties is contrary to [article I]." Roessler, *supra* note 120, at 605.

171. See Liebman, *supra* note 120, at 253.

172. But see Comment, *supra* note 60, at 319 ("The typical countertrade transaction may violate the most favored nation principle."). The commentator offers only a hypothetical—an unconvincing one at that—to support his assertion. He assumes that developing country X imports grain and exports tin. X imposes countertrade on country Y, forcing it to market X's tin. However, country A has no marketing expertise, so X simply buys grain from A. This model is unrealistic. First, Y is likely to be a corporation, not a country subject to GATT obligations, and X will probably not care where the corporation is located. Second, Y will almost certainly not "buy" grain from underdeveloped A; Y will insist on some kind of barter arrangement if one is not already in place.

173. See J. JACKSON, *supra* note 117, § 11.3.

not with others, it might be tempting to assert that this type of countertrade violates the MFN principle. Article I, however, was never meant to reach bilateral clearing arrangements. In light of the strong GATT preference for multilateral cash payments, it would be perverse to require that the "benefit" of such arrangements be accorded to all contracting parties. Bilateral clearing facilitates East-South and South-South trade in the face of illiquidity. Clearing arrangements do not discriminate against Western traders; rather, they enable LDCs and nonmarket countries to approximate trade with the West. Like other forms of countertrade, bilateral clearing does not violate the GATT most favored nation obligation.

### b. *The National Treatment Principle*

GATT article III contains the basic statement of the national treatment principle:

The products of the territory of any contracting party imported into the territory of any other contracting country shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.<sup>174</sup>

Article III covers any internal tax or regulation affecting internal sales, whether applied within the contracting party or at its borders.<sup>175</sup> Through the norm of national treatment, the GATT seeks to foreclose protection of domestic industries by contracting parties.<sup>176</sup>

Although there is little to indicate that countertrade has been used as a protectionist device, commentators suggest that countertrade requirements that tie the level of imports to the level of exports violate article III.<sup>177</sup> "Obviously," writes one, "a producer whose goods cannot be imported unless they are linked with an export is worse off than a domestic producer who does not have to satisfy such a requirement."<sup>178</sup>

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174. GATT, *supra* note 5, art. III(4).

175. *Id.* annex I (article III).

176. *See id.* art. III(1) (internal taxation and regulation "should not be applied to imported or domestic products so as to afford protection to domestic production"); J. JACKSON & W. DAVEY, *supra* note 115, at 484-85. Article III also fosters liberalized trade by decreasing distortionary government interference in trade flows. *Id.* at 483.

177. Gadbaw, *supra* note 119, at 360. *Accord* Czinkota & Talbot, *supra* note 117, at 160. Such a tie is only present in commercial compensation; it is difficult to imagine how industrial compensation would raise any national treatment issue. Industrial compensation agreements provide for large-scale facilities that are unavailable in the domestic (host) market.

178. Czinkota & Talbot, *supra* note 117, at 160.

The applicability of article III is not so obvious, however, because national treatment proscribes only *internal* regulation.<sup>179</sup> "It was . . . the intention of the drafters . . . clearly to treat the imported products in the same way as the like domestic products *once they had been cleared through customs*."<sup>180</sup>

Countertrade is not an internal regulation.<sup>181</sup> Countertraded goods come into a country in the same manner as any other goods. Once imported, they are subject to exactly the same conditions as, and compete freely with, "like" domestic products. Southern and Eastern governments often use countertrade to obtain Western goods and services for which there is no like product of national origin.<sup>182</sup> Moreover, by overcoming economic and political rigidities, barter-like trade makes importation possible in the first place.<sup>183</sup> In a second-best world, countertrade policies allow foreign products to compete with domestic products without imposing internal regulation. Therefore, countertrade is consistent with the article III national treatment principle.

The possibility of discrimination against imports in government procurement policies presents a separate issue. Many developing countries use offset financing to cushion the shock of large government purchases. These transactions, however, are almost entirely military and thus are not within the purview of the GATT.<sup>184</sup> In addition, article III specifically exempts government procurement from the national treatment obli-

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179. See GATT, *supra* note 5, art. III. See generally J. JACKSON, *supra* note 117, § 12.4.

180. *Italian Discrimination Against Imported Agricultural Machinery*, BISD, *supra* note 5, 7th Supp., at 64 (1959) (report by Panel for Conciliation) (Italian law providing concessionary credit to certain farmers for purchase of Italian-made farm machinery found inconsistent with obligations under Article III) (emphasis added). *Accord Canadian FIRA*, *supra* note 149, at 160, 162.

181. Many of the GATT complaints under Article III have involved internal taxes. See J. JACKSON & W. DAVEY, *supra* note 115, at 495-96 (listing cases). One practitioner draws an analogy between domestic content regulation and countertrade. See Gadbaw, *supra* note 119, at 360. He refers to a GATT panel report which held that the European Economic Community's domestic content measures violated article III. See *EEC—Measures on Animal Feed Proteins*, BISD, *supra* note 5, 25th Supp., at 65 (1979). The EEC required domestic importers of feeds to purchase specific quantities of skim milk powder for use in the feeds. In reaching its conclusion the panel found that the measures were internal regulations designed to protect domestic production. *Id.* Countertrade policies do not require that imported goods be altered in any way, and there is little evidence to indicate that barter-like trade is designed to protect domestic industries. Thus, this case does not say much about the applicability of article III to countertrade.

182. See, e.g., *supra* note 105.

183. See *supra* text accompanying note 60.

184. See GATT, *supra* note 5, art. XXI(b)(ii) (GATT does not cover traffic in weapons or other military material). See also text accompanying note 136.

gation.<sup>185</sup> The new Government Procurement Code does commit all signatories to MFN and national treatment in procurement,<sup>186</sup> but it contains a much weaker statement opposing offset procurement.<sup>187</sup> Besides, only one LDC (and no nonmarket country) has accepted the Code.<sup>188</sup> For those reasons, the General Agreement has very little bearing on countertrade in government procurement.

### c. *State Trading*

Some developed countries, most developing countries, and all nonmarket countries use state trading enterprises extensively in their foreign economic affairs.<sup>189</sup> The General Agreement has always displayed a distinct free market orientation; basic GATT rules are quite unsatisfactory when applied to state trading enterprises.<sup>190</sup> Still, the drafters recognized that these enterprises, through ordinary buy or sell transactions, can engage in discrimination.<sup>191</sup> Article XVII embodies the drafters' attempt at extending free market norms of nondiscrimination to the context of state trading.<sup>192</sup> Under article XVII, each enterprise must, "in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting im-

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185. GATT, *supra* note 5, art. III(8)(a). "[I]t is generally considered that the MFN obligation also does not apply to government purchases." J. JACKSON & W. DAVEY, *supra* note 115, at 522 (footnote omitted).

186. *Agreement on Government Procurement*, BISD, *supra* note 5, 26th Supp., at 33, art. II(1) (1980) [hereinafter *Procurement Code*].

187. *Id.* art. V(14)(h) (procurement entities "should normally refrain" from offset contracts, and when they use offset, they must limit it to "a reasonable proportion within the contract value and shall not favour suppliers from one Party over suppliers from any other Party"). See Roessler, *supra* note 120, at 608-09.

188. J. JACKSON & W. DAVEY, *supra* note 115, at 330 (as of Feb. 24, 1986). See also *Procurement Code*, *supra* note 186, art. III (special treatment for developing countries).

189. Cf. J. JACKSON & W. DAVEY, *supra* note 115, at 1174-75. Eastern bloc countries import and export through foreign trade organizations, each of which handles a specific range of goods. See generally Barrett, *East Bloc Counts on Counter Trade*, EUROMONEY, Sept. 1987, at 465, 468. Developing countries too channel international trade through state-sponsored monopolies; India's State Trading Corporation is a leading example. See generally Behara, *Can Countertrade Achieve its Promise?*, TRADE FIN., Mar. 1988, at 49. For the purposes of this discussion, state trading enterprises also include any enterprise receiving from a government "exclusive or special privileges" within the meaning of GATT, *supra* note 5, art. XVII(1)(a). The very difficult problem of determining which enterprises are subject to the terms of article XVII, see generally J. JACKSON, *supra* note 117, § 14.4, is beyond the scope of this article.

190. See, e.g., J. JACKSON & W. DAVEY, *supra* note 115, at 1175.

191. Gadbaw, *supra* note 119, at 361.

192. GATT, *supra* note 5, art. XVII(1)(a).

ports or exports by private traders."<sup>193</sup> Article XVII further provides that this obligation is fulfilled if the enterprise acts "solely in accordance with commercial considerations."<sup>194</sup>

The state trading article presents "major interpretive difficulties,"<sup>195</sup> and a relevant body of case law has not emerged.<sup>196</sup> Apparently, the contracting parties continue to manifest a "desire . . . to avoid the tough questions in dealing with state trading."<sup>197</sup> It is clear that article XVII does not impose a national treatment requirement on state enterprises.<sup>198</sup> "Thus the enterprise is entitled to discriminate between domestic and foreign products in its purchases or its sales, as long as it does so on an MFN basis."<sup>199</sup> Countertrade in general does not violate the most favored nation principle;<sup>200</sup> furthermore, the article XVII MFN requirement is a weak one.<sup>201</sup> Hence, article XVII does not prohibit countertrade.<sup>202</sup>

Instead, it must be asked whether a nation may do through a state trading activity what it cannot do otherwise under GATT.<sup>203</sup> In light of the foregoing discussion, there is a distinct possibility that countries can use the state trading provisions as a safe harbor for countertrade. If countertrade comports with commercial considerations including price, quality, or marketability, it may comply with the MFN principle.<sup>204</sup> What is more, state enterprises are entitled to take tied loans into account as commercial considerations,<sup>205</sup> and countertrade may be concep-

193. *Id.*

194. *Id.* art. XVII(1)(b).

195. Gadbaw, *supra* note 119, at 362.

196. Gadbaw, *supra* note 119, at 362. See J. JACKSON, *supra* note 117, § 14.5.

197. Gadbaw, *supra* note 119, at 362. See Roessler, *supra* note 120, at 606.

198. See J. JACKSON & W. DAVEY, *supra* note 115, at 1182. See also *Canadian FIRA*, *supra* note 149, at 163 ("The Panel saw great force in Canada's argument that only the most-favoured-nation and not the national treatment obligations fall within the scope of the general principles referred to in Article XVII:1(a).") (dictum); Roessler, *supra* note 120, at 606; Liebman, *supra* note 120, at 256-57.

199. J. JACKSON & W. DAVEY, *supra* note 115, at 1182. See Roessler, *supra* note 120, at 606.

200. See *supra* notes 170-72 and accompanying text.

201. E.g., Liebman, *supra* note 120, at 256-57.

202. *Contra* Gadbaw, *supra* note 119, at 362. Gadbaw asserts, with no discernible support, that "a strong case can be made that countertrade involves both discriminatory effects and considerations alien to those present in normal commercial transactions in violation of Article VII." *Id.*

203. J. JACKSON, *supra* note 117, § 14.3.

204. See GATT, *supra* note 5, art. XVII(1)(b). Arguably, the article XVII provision preempts application of the stronger article I MFN obligation.

205. *Id.* annex I (Ad Article XVII). A tied loan occurs when one country lends money to

tualized as a tied loan.<sup>206</sup>

### 3. Subsidies

A few writers have tentatively suggested that countertrade may violate the export subsidies provisions of the GATT and the Subsidies Code.<sup>207</sup> This area is complex,<sup>208</sup> only an introduction to the issues will be attempted here.

The original General Agreement contained only one paragraph of obligations concerning subsidies.<sup>209</sup> That paragraph contained a broad subsidy definition, but imposed no obligation beyond a notification requirement. The 1954-1955 GATT review session added four more substantive paragraphs to article XVI,<sup>210</sup> but the revisions were only accepted by developed countries.<sup>211</sup> Thus, until the conclusion of the Tokyo Round, the net effect of article XVI outside the industrialized countries was minimal.<sup>212</sup> The Subsidies Code sought to remedy these weaknesses, but has been signed by only eleven LDCs and not a single nonmarket country.<sup>213</sup> "Consequently, most GATT members are not obligated to refrain from the use of export subsidies."<sup>214</sup>

For those that are obligated, the Subsidies Code imposes two principal rules. First, "[s]ignatories shall not grant export subsidies on prod-

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another country on the condition that the money be spent on goods from the lending country. J. JACKSON, *supra* note 117, § 12.6.

206. Liebman, *supra* note 120, at 257-58.

207. Czinkota & Talbot, *supra* note 117, at 161; Liebman, *supra* note 120, at 255-56; Comment, *supra* note 60, at 335-36. Violation of the provisions that give rise to claims for compensation must be distinguished from actions that are not prohibited and are merely countervailing. J. JACKSON & W. DAVEY, *supra* note 115, at 711. See GATT, *supra* note 5, art. VI; *Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade*, BISD, *supra* note 5, 26th Supp., at 56, pt. 1 (1980) [hereinafter Subsidies Code].

208. See, e.g., J. JACKSON & W. DAVEY, *supra* note 115, at 724.

209. E.g., *id.* at 727. See also GATT, *supra* note 5, art. VI (countervailing duties). That paragraph is now *id.* art. XVI(A)(1).

210. GATT, *supra* note 5, art. XVI(1)-(5). Even the obligations in these paragraphs are best described as "tentative." J. JACKSON, *supra* note 117, § 15.3.

211. J. JACKSON & W. DAVEY, *supra* note 115, at 728 & n.4.

212. See *id.*

213. See J. JACKSON & W. DAVEY, *supra* note 115, at 330 (as of Feb. 24, 1986). In light of this discussion and a recent decision of the U.S. Court of Appeals for the Federal Circuit, it seems clear that nonmarket economies are subject to no obligations whatsoever under GATT with respect to subsidies. See *Georgetown Steel Corp. v. United States*, 801 F.2d 1308 (Fed. Cir. 1986). In *Georgetown Steel*, the court held that certain imports from Czechoslovakia, Poland, and the Soviet Union were not subject to the anti-subsidies provisions of the Tariff Act of 1930, as amended. The court reasoned that the concept of unfair export subsidies cannot exist for imports from nonmarket economies. *Id.* at 1314-15.

214. J. JACKSON & W. DAVEY, *supra* note 115, at 728 (footnote omitted).



ucts other than certain primary products.”<sup>215</sup> Second, “signatories agree not to grant directly or indirectly any export subsidy on certain primary products in a manner which results in the signatory granting such subsidy having more than an equitable share of world export trade in such product. . . .”<sup>216</sup> Rather than attempt to define “export subsidy,” the Code provides an illustrative list,<sup>217</sup> which does not include countertrade explicitly. Given the wide divergence of views on the subject,<sup>218</sup> it would be very difficult to assemble a consensus that countertrade represents an impermissible export subsidy.<sup>219</sup>

Two commentators have suggested that countertrade, in and of itself, is an export subsidy.<sup>220</sup> First, countertrade may involve a governmental purchase of imports at a price greater than the market price.<sup>221</sup> The resulting “bonus,” this argument asserts, may find its way into the price of the tied exports. The purported bonus, however, is much more attenuated than any “charge on the public account” in the Subsidies Code’s illustrative list. The whole transaction increases imports, a result diametrically opposed to the GATT concern with import-inhibiting subsidies.<sup>222</sup> The heightened payment for imports may better be viewed as facilitating trade by defraying costs associated with market failure.<sup>223</sup> Second, according to another writer, countertrade is “conceivably” a species of currency retention scheme.<sup>224</sup> This is unintelligible.<sup>225</sup>

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215. Subsidies Code, *supra* note 207, art. 9(1).

216. *Id.* art. 10(1).

217. *Id.* art. 9(2). *See id.* annex. The list is quite broad, and contains a catch-all phrase, designed to encompass “[a]ny other charge on the public account constituting an export subsidy in the sense of article XVI of the General Agreement.” *Id.*

218. *See J. JACKSON & W. DAVEY, supra* note 115, at 724.

219. Liebman, *supra* note 120, at 256.

220. Countertrade cannot be an impermissible production subsidy. *See generally* Subsidies Code, *supra* note 207, art. 2.

221. Czinkota & Talbot, *supra* note 117, at 161.

222. *See* GATT, *supra* note 5, art. XVI(1).

223. *See, e.g., supra* text accompanying note 87. According to one observer, the GATT seeks only to proscribe “pure” export subsidies. *See* Comment, *supra* note 60, at 336. Subsidies that alleviate internal anti-competitive rigidities faced by exporters—“compensatory” export subsidies—are consistent with the GATT. *Id.* Countertrade functions as a compensatory subsidy because it alleviates market imperfections that restrict exports. *See supra* Section II.B.

224. Liebman, *supra* note 120, at 255. *See* Subsidies Code, *supra* note 207, annex (example (b)).

225. It is true that a government countertrade policy might include a currency retention scheme. *See* Czinkota & Talbot, *supra* note 117, at 161. *See also* Comment, *supra* note 60, at 335 (India grants credits to, and reduces taxes for, companies that promote exports through countertrade). The scheme would provide an impermissible subsidy, regardless of whether export transactions involved countertrade. Countertrade, however, does not constitute a currency retention scheme, nor does it encourage the use of export subsidies.

Even if a country is bound by GATT subsidies obligations, and even if its countertrade practices constitute an export subsidy, the practices may still come within the developing countries provisions of the Subsidies Code.<sup>226</sup> Specifically, the Code recognizes "that subsidies are an integral part of economic development programmes of developing countries,"<sup>227</sup> disclaims any intention of preventing LDCs from assisting their export sectors, and distinctly softens the ban on export subsidies related to nonprimary products.<sup>228</sup> Thus, countertrade does not violate the GATT provisions on subsidies.

#### 4. Miscellaneous Provisions

Countertrade could possibly violate various other GATT provisions that will now be reviewed briefly. At the center of the system of GATT obligations lies the tariff concession, which commits a contracting party "to levy no more than a stated tariff on a particular item."<sup>229</sup> Article II "requires state import monopolies not to resell imported goods at a monopoly premium that is higher than the applicable tariff" contained in the schedule of concessions.<sup>230</sup> It can be argued that countertrade practiced by an import monopoly may violate the principles of article II.<sup>231</sup> However, countertrade is a means of permitting imports under adverse conditions. The import monopoly provisions of article II, moreover, are almost wholly inapplicable to Eastern and Southern countries.<sup>232</sup>

Because countries often require countertrade without publishing standards, they may also violate the transparency rules set forth in article X.<sup>233</sup> This is not a serious problem, however, because article X is impotent in practice.<sup>234</sup> A related complaint is that countertrade conceals dumping,<sup>235</sup> but the price and volume details of most countertrade deals

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226. Subsidies Code, *supra* note 207, art. 14.

227. *Id.* art. 14(1).

228. *Id.* art. 14(2).

229. J. JACKSON, *supra* note 117, § 10.1.

230. Baker & Cunningham, *supra* note 120, at 377.

231. Gadbow, *supra* note 119, at 360, 363.

232. Baker & Cunningham, *supra* note 120, at 377 (Article II(4) is "plainly unenforceable in centrally planned economies"); *infra* notes 249-251 and accompanying text (discussion of accession protocols); J. JACKSON & W. DAVEY, *supra* note 115, at 1141 (scope of article II limited because many developing countries have very short tariff schedules or no schedule at all). Countertrade and barter may be more difficult to value for customs purposes. For a discussion of applicable rules, see Roessler, *supra* note 120, at 612-13.

233. Comment, *supra* note 60, at 325. See GATT, *supra* note 5, art. X(1).

234. Article X has not been used much. See J. JACKSON, *supra* note 117, § 17.7. Contracting parties are unlikely to invoke the GATT dispute resolution procedures solely to force a countertrading member to publish standards.

235. See, e.g., *Impact of Countertrade*, *supra* note 41, at 33-34 (statement of James P.

are no less transparent than those of cash transactions.<sup>236</sup>

Countertrade does not violate any of the key provisions of the GATT directed against quantitative restrictions, discrimination, or subsidies. Nonetheless, if countertrade policies nullify or impair any benefit accruing to a contracting party under the GATT, that party may seek corrective, retaliatory, or compensatory relief.<sup>237</sup> Even if countertrade could theoretically come within the nullification and impairment provision, it is inconceivable that a GATT action will be brought solely on this basis.<sup>238</sup>

## 5. Countertrade, the GATT, and the Integration of World Trade

The preceding sections demonstrate that restrictive GATT provisions should be read to tolerate countertrade as a second-best policy. Most demands for countertrade come from governments in nonmarket countries or developing countries. The fact that these countries are not well integrated into the GATT system complicates analysis.<sup>239</sup> However, countertrade allows countries not only to overcome the integration problem, but also to complement and supplement the GATT legal regime. This section considers the legality of Eastern bloc countertrade policies and then suggests that there should be a developing country exception for countertrade.

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Moore, Jr., Deputy Assistant Secretary of Commerce). Dumping is governed by article VI and the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade*, BISD, *supra* note 5, 26th Supp., at 171 (1980) [hereinafter Anti-Dumping Code]. These provisions do not make dumping a violation, and "the General Agreement does not impose on contracting parties the obligation to prevent enterprises from dumping." *Canadian FIRA*, *supra* note 149, at 164. Rather, the GATT authorizes self-help in the form of countervailing duties. GATT, *supra* note 5, art. VI; Anti-Dumping Code, *supra*, art. 8. Neither does countertrade render dumping more likely. See Banks, *supra* note 6, at 176-77.

236. Banks, *supra* note 6, at 176. See *supra* note 69 and accompanying text (countertrade often transacted at market prices, through market channels). With respect to nonmarket economies, it is difficult to determine prices regardless of whether countertrade is used. Banks, *supra* note 6, at 171.

237. GATT, *supra* note 5, art. XXIII; Roessler, *supra* note 120, at 612; Comment, *supra* note 60, at 341.

238. Article XXIII is so broad as to be weak, J. JACKSON & W. DAVEY, *supra* note 115, at 352, and defective, *id.* at 345-46. Suspension of concessions requires a majority vote of contracting parties, which is difficult to obtain. *Id.* at 336. Members have been reluctant to bring article XXIII actions for fear of offending other members. *Id.* Not surprisingly, there has been only one article XXIII case involving the actual suspension of concessions. Jackson, *GATT Machinery and the Tokyo Round Agreements* in *TRADE POLICY IN THE 1980s* (W. Cline ed. 1983), excerpted in *id.* at 333-36.

239. See *supra* note 126.

a. *Nonmarket Economies*

Beyond the state trading provisions previously discussed,<sup>240</sup> the body of the GATT does not even seek to address the problem of planned economies.<sup>241</sup> Nonetheless, commentators have suggested that the socialist countries violate the most favored nation principle of the General Agreement by imposing countertrade requirements on traders in market-oriented countries.<sup>242</sup> The argument is that nonmarket countries do not practice countertrade among themselves.<sup>243</sup>

This argument is flawed. First, Eastern European countries use countertrade precisely because it "approximates the trading methods of the Council for Mutual Economic Assistance."<sup>244</sup> Second, "because of the difficult political questions raised by [the MFN] question, it was largely not treated in" the nonmarket countries' accession protocols.<sup>245</sup> Third, the countertrade practices of Czechoslovakia and Hungary do not pose much of a threat to GATT norms because these practices cause little or no deviation from ordinary market transactions.<sup>246</sup> Fourth, the regional integration exception of article XXIV may insulate intra-CMEA trade from operation of the MFN principle.<sup>247</sup> Finally, the scope of any

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240. See *supra* notes 189-206 and accompanying text.

241. Gadbow, *supra* note 119, at 363.

242. See, e.g., Liebman, *supra* note 120, at 253.

243. *Id.*

244. de Miramon, *supra* note 46, at 348. Yugoslavia, although not a CMEA member, maintains clearing arrangements with the Eastern Bloc countries.

245. J. JACKSON & W. DAVEY, *supra* note 115, at 1187. See *Protocol for the Accession of Hungary to the General Agreement on Tariffs and Trade*, BISD, *supra* note 5, 20th Supp., at 3 (1974); *Protocol for the Accession of Romania to the General Agreement on Tariffs and Trade*, BISD, *supra* note 5, 18th Supp., at 5 (1972) [hereinafter Romania Protocol]; *Protocol for the Accession of Poland*, BISD, *supra* note 5, 15th Supp., at 46 (1968) [hereinafter Poland Protocol]. Yugoslavia's accession was thought not to raise similar problems, see J. JACKSON & W. DAVEY, *supra* note 115, at 1183, and that country has long been treated as a full contracting party, see K. KOCK, *supra* note 123, at 217-18. Cuba and Czechoslovakia joined the GATT while they still had market economies. See J. JACKSON & W. DAVEY, *supra* note 115, at 1183.

246. Czechoslovakia is not a major practitioner of countertrade, and its products are easily sold on world markets. Vogt & Nowak, *Countertrade—As Practiced in Eastern Europe*, in BARTER IN THE WORLD ECONOMY 87 (B. Fisher & K. Harte eds. 1985). The Hungarian government encourages countertrade only when the Western partner has access to appropriate marketing. USITC (1985), *supra* note 3, at 126 app. I. See also Vogt & Nowak, *supra*, at 88-89 (government publicly opposes countertrade in other instances). Hungarian countertrade has many market features; "the Hungarian motivation for countertrade emanates more from a desire to develop the economy than from a rigid adherence to bilateral balancing . . ." *Id.* at 89.

247. Liebman, *supra* note 120, at 254. Yugoslavia, which is not a CMEA member, *id.*, presents special problems. Yugoslavia's bureaucracy operates so as to require countertrade unofficially for almost all imports, and countertrade is managed at the provincial level. USITC (1985), *supra* note 3, at 129. Information on the countertrade practices of Cuba is scarce.

such discrimination is limited by the small number of nonmarket contracting parties.<sup>248</sup> Any possible violation of MFN by nonmarket countries' countertrade practices would be insignificant. Indeed, the accession protocols may exempt certain socialist countries from operation of GATT nondiscrimination rules.<sup>249</sup> The protocols focus solely on raising the volume of imports from other GATT members.<sup>250</sup> Therefore, Romania and Poland may be absolutely free to countertrade on a discriminatory basis, so long as they comply with the provision of their accession protocols requiring import growth.<sup>251</sup>

There exist fundamental problems in integrating nonmarket economies into the GATT legal framework.<sup>252</sup> National treatment, the ban on quantitative restrictions, subsidies, and tariff reductions have no meaning in planned economies which set import and export levels in advance.<sup>253</sup> On the other hand, the GATT, both as an institution and as a body of rules, strives to integrate socialist countries into the world economy through international trade. Countertrade acts as an interface between East and West and therefore supports GATT objectives.<sup>254</sup> Adopting the approach of the Polish or Romanian accession protocols—obligating socialist countries only to demonstrate increased imports as a measure of trade liberalization—is a more sensible way of dealing with East-West trade than struggling to apply GATT rules to countertrade.<sup>255</sup>

b. *A Developing Country Exception for Countertrade*

Sprinkled throughout the GATT are provisions that soften key obligations for developing countries.<sup>256</sup> Recognizing that a piecemeal approach would not sufficiently address the problems and concerns of the

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248. See *supra* note 137.

249. See Baker & Cunningham, *supra* note 120, at 377-78; protocols cited *supra* note 245. See also *id.* (no MFN in protocols).

250. Baker & Cunningham, *supra* note 120, at 377. See Poland Protocol, *supra* note 245, at 52 annex B (obligation to increase total imports from contracting parties 7% per annum); Romania Protocol, *supra* note 245, at 10 annex B (obligation to increase total imports from contracting parties in proportion to increase in total imports, as provided in national plan).

251. Baker & Cunningham, *supra* note 120, at 377.

252. J. JACKSON & W. DAVEY, *supra* note 115, at 1180.

253. *Id.*

254. See *supra* notes 113-114 and accompanying text.

255. Baker & Cunningham, *supra* note 120, at 378 ("Unless GATT members are willing to search out and proscribe all of the countless subtle ways by which a state-controlled economy can discriminate against particular countries or can limit particular classes of imports, it makes little sense to attack countertrade on the ground that it may be used for these purposes.").

256. See, e.g., *supra* note 161 (balance of payments safeguard); *supra* notes 226-228 and accompanying text (subsidies). See generally Comment, *supra* note 60.

developing world, the drafters incorporated article XVIII, which is devoted entirely to government assistance for economic development.<sup>257</sup> When that article proved insufficient,<sup>258</sup> the contracting parties adopted part IV (trade and development) of the GATT.<sup>259</sup> Despite continuing efforts by the membership of GATT,<sup>260</sup> LDCs remain extremely dissatisfied.<sup>261</sup>

The GATT will never fully address the problems of development. The document largely presumes free international markets. The GATT assumes that trade in goods is separable from other international economic issues like foreign investment. Consequently, the GATT is bound to a static view of comparative advantage. But in today's world, comparative advantage can be manipulated; governments channel investment and create trade.<sup>262</sup> In the final analysis, GATT rules presume that governmental controls are uneconomic; that is to say, they will be exercised to reduce trade and economic advantages.<sup>263</sup>

As a key development tool,<sup>264</sup> countertrade mediates between the laissez-faire principles and the economic development articles of the GATT. Article XVIII and part IV can and should support a general exception for countertrade as a development policy.<sup>265</sup>

Article XXXVI, which contains the principles and objectives of the GATT rules on trade and development, reads like a catalog of the goals of LDCs served by countertrade as a second-best policy:<sup>266</sup> increased

257. See generally J. JACKSON, *supra* note 117, § 25.1.

258. *Id.* § 25.4.

259. GATT, *supra* note 5, arts. XXXVI-XXXVIII. Part IV entered into force in 1966. J. JACKSON & W. DAVEY, *supra* note 115, at 1143.

260. See, e.g., J. JACKSON & W. DAVEY, *supra* note 115, at 1154-66 (General System of Preferences).

261. See, e.g., UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, REPORT BY THE SECRETARY-GENERAL OF UNCTAD: ASSESSMENT OF THE RESULTS OF THE MULTILATERAL TRADE NEGOTIATIONS (1982), excerpted in *id.* at 144-49 (from perspective of developing countries, results of Tokyo Round were wanting in many respects).

262. G. WINHAM, *supra* note 126, at 404-05.

263. J. JACKSON, *supra* note 117, § 14.1. Accord G. WINHAM, *supra* note 126, at 405.

264. See *supra* text accompanying notes 102-103.

265. There may already be a de facto GATT exception for LDCs. See J. JACKSON & W. DAVEY, *supra* note 115, at 1141 (GATT tends to overlook LDC actions that are technically inconsistent with GATT obligations). The General Agreement provides general exceptions which may be applicable to particular countertrade policies. See GATT, *supra* note 5, art. XIX (escape clause); Liebman, *supra* note 120, at 258 (escape clause is easily invoked and may apply to countertrade). See also GATT, *supra* note 5, art. XX (general exceptions); *id.* art. XXI (security exceptions).

266. GATT, *supra* note 5, art. XXXVI. See also *id.* art. XXXVIII (joint action for development). Cf. Comment, *supra* note 60, at 320 (countertrade may raise standard of living of LDCs and further aims of GATT part IV). Part IV largely favors "less-developed countries," a

export earnings,<sup>267</sup> greater access to world markets for primary<sup>268</sup> and nontraditional goods,<sup>269</sup> fair terms-of-trade,<sup>270</sup> diversification of exports,<sup>271</sup> stabilization of trade flows,<sup>272</sup> and interrelationship of trade and aid<sup>273</sup>—in sum, economic development.<sup>274</sup> Article XXXVIII requires contracting parties to collaborate to further these objectives.<sup>275</sup> For example, parties must act

to provide improved and acceptable conditions of access to world markets for primary products of particular interest to less developed contracting parties and to devise measures designed to stabilize and improve conditions of world markets in these products including measures designed to attain stable, equitable and remunerative prices for exports of such products.<sup>276</sup>

Countertrade fits well with this obligation. Moreover, countertrade as a development policy is far less distortionary than protective devices, such as import quotas, that are commonly used by less-developed contracting parties.<sup>277</sup> Barter-like trade does not break the link between domestic

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deceptive term for a very diverse group of countries. The General Agreement provides a two-part test for defining an LDC: A contracting party is considered an LDC if its "economy can only support low standards of living and is in the early stages of development. GATT, *supra* note 5, art. XVIII(4)(a). See *id.* annex I (article XVIII) (definition includes parties "undergoing a process of industrialization to correct an excessive dependence on primary production"). Therefore, most Eastern parties, though concerned with economic development, are not automatically afforded differential treatment. But see *id.* art. XVIII(4)(b), (22) (party in process of development, but not coming within scope of *id.* art. XVIII(4)(a), may apply for differential treatment); Liebman, *supra* note 120, at 260 & n.49 (Romania may be LDC for GATT purposes).

267. GATT, *supra* note 5, art. XXXVI(1)(a), (2).

268. *Id.* art. XXXVI(4). See *id.* arts. XVIII(5) & XXXVII.

269. *Id.* art. XXXVI(5). See also *supra* notes 102-109 and accompanying text.

270. GATT, *supra* note 5, art. XXXVI(1)(b), (4). See also *supra* note 107 and accompanying text.

271. GATT, *supra* note 5, art. XXXVI(5). See also *supra* text accompanying note 105.

272. GATT, *supra* note 5, art. XXXVI(4). See also *supra* note 91 and accompanying text.

273. GATT, *supra* note 5, art. XXXVI(6). See also *supra* note 105 and accompanying text.

274. GATT, *supra* note 5, art. XXXVI(1)(a). See *id.* art. XVIII(1). See also *supra* notes 102-109 and accompanying text.

275. GATT, *supra* note 5, art. XXXVIII(1) (parties "may enable less-developed contracting parties to use special measures to promote their trade and development"); *id.* art. XXXVIII(1)(f).

276. *Id.* art. XXXVIII(2)(a).

277. See I. OUTTERS-JAEGER, *supra* note 1, at 58 ("Although both political and economic reasons have been instrumental in the decision of developing countries to carry out a more or less large part of their foreign trade on a barter-like basis, it appears that economic problems have been most decisive.").

Less-developed countries often use quotas to launch infant industries. See generally J. JACKSON, *supra*, note 117, § 13.2.

and world prices.<sup>278</sup> Countertrade is also more effective as a development tool than are protective devices.<sup>279</sup> To apply the restrictive provisions of the GATT against development-targeted countertrade would be hypocritical and counterproductive.

## B. Summary

To summarize, countertrade in and of itself is unlikely to violate the restrictive provisions of the General Agreement. Countertrade does not constitute a quantitative restriction, nor does it violate the GATT norm of nondiscrimination as embodied in the most favored nation and national treatment principles. Countertrade policies do not confer an impermissible subsidy. Even if covered by these or other restrictive provisions, barter-like trade may benefit from specific exceptions embedded in the substantive law of GATT. When GATT rules reach out to cover state trading enterprises or nonmarket economies, they are more likely to authorize than to limit countertrade. Finally, bilateral trade in the service of economic development may be exempt from operation of the primary GATT norms.

There remain other practical considerations relevant to pursuing countertrade under the rules of GATT. Contracting parties may, with relative ease, obtain waivers of obligations.<sup>280</sup> "[T]here is the final practical consideration of how a potentially real violation of the GATT can be pursued and remedied,"<sup>281</sup> because the GATT dispute resolution apparatus is cumbersome and weak.<sup>282</sup> For all these reasons, it is clear that "the GATT does little to regulate countertrade demands."<sup>283</sup>

## V. COUNTERTRADE AND THE GATT SYSTEM

Recognizing this, critics have suggested an institutional response—revising the GATT to regulate countertrade.<sup>284</sup> The United States Government has even insisted on early discussion of countertrade in the new Uruguay Round of trade talks.<sup>285</sup> There is, however, little chance that the contracting parties will be able to agree on measures regulating

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278. See *supra* text accompanying notes 150-55.

279. See *supra* notes 102-09 and accompanying text.

280. Liebman, *supra* note 120, at 260-61. See GATT, *supra* note 5, art. XXV(5). No party has ever requested a waiver to permit countertrade. Liebman, *supra* note 120, at 260.

281. Liebman, *supra* note 120, at 261.

282. See generally J. JACKSON & W. DAVEY, *supra* note 115, at 337-57.

283. Baker & Cunningham, *supra* note 120, at 376.

284. See, e.g., Verdun, *supra* note 2, at 214.

285. GATT Finds Over 120 Trade Restrictions Against its Rules, Several of them Recent, 3 Int'l Trade Rep. (BNA) 842 (June 25, 1986).



countertrade.<sup>286</sup>

Experts consider amending the GATT to be nearly impossible.<sup>287</sup> Equally unlikely would be a new countertrade side-agreement negotiated under the aegis of the GATT and patterned after the MFN Codes.<sup>288</sup> First, the countertrade issue cuts to the heart of stubborn GATT policy dilemmas, especially the treatment of poorer countries, development, and nonmarket economies; predictably, there is a wide divergence of views on the subject.<sup>289</sup> Second, countertrade is a minor<sup>290</sup> and low-priority<sup>291</sup> issue for GATT members. Third, perhaps because all countries use barter, no country is likely to push the countertrade issue seriously at GATT negotiations.<sup>292</sup> Finally, any side-agreement would only be enforceable by and against signatories. Past experience indicates that Eastern and Southern countries would be very reluctant to sign.<sup>293</sup>

Thus, the contracting parties are not likely to act affirmatively to bring countertrade within the GATT legal framework, nor should they. Countertrade as a second-best policy is consistent with the goals of the GATT. As has recently been observed,

there is no reason for GATT to take a strong stand against proliferation of countertrade, or to attempt to officially bring it under its jurisdiction by issuing guidelines and regulations. [I]t may be the only practicable solution to current world trade dislocations. . . . Proliferation of countertrade is a symptom of world economic difficulty rather

286. BUSINESS INT'L CORP., *supra* note 2, at 36.

287. J. JACKSON & W. DAVEY, *supra* note 115, at 310-11.

288. See, e.g., Subsidies Code, *supra* note 207.

289. Parry, *supra* note 80, at 40 (quoting Felipe Jaramillo, Colombian Ambassador to the GATT and leading Third World spokesman, who expressed "doubts as to the legality of bringing [countertrade] under GATT"). See Czinkota & Talbot, *supra* note 117, at 167.

290. BUSINESS INT'L CORP., *supra* note 2, at 34 (GATT officials consider countertrade a minor issue, now and in the future, for all contracting parties except possibly the United States.).

291. Czinkota & Talbot, *supra* note 117, at 168 (higher priorities include technology transfer and services).

292. *Id.* at 167. The only real candidate is the United States. However, the American Government intends to continue bartering "in situations which offer advantages not offered by conventional market operations," *Impact of Countertrade*, *supra* note 41, at 49 (attachment I) (Statement of Charles H. Blum, acting Assistant United States Trade Representative for Industrial Trade Policy), and its overall countertrade policy is inconsistent. McVey, *Policy Issues in Countertrade*, in *BARTER IN THE WORLD ECONOMY* 272 (S. Fisher & K. Harte eds. 1985). See generally Note, *Bauxite for Butter: The U.S.-Jamaican Agreement and the Future of Barter in U.S. Trade Policy*, 16 LAW & POL'Y INT'L BUS. 239 (1984).

293. See *supra* text accompanying notes 188 (no Eastern country and only one LDC has signed the Government Procurement Code) and 213 (no Eastern country and only eleven LDCs signed the Subsidies Code).

than the problem itself.<sup>294</sup>

If a contracting party challenges countertrade requirements via the GATT dispute resolution apparatus, the panel should ask whether the requirements operate as a second-best policy. If so, the panel should find that the countertrade policy does not violate GATT rules. If instead the requirements are intended solely to restrict trade,<sup>295</sup> the panel should proceed as it would for any other violation of a GATT obligation.

## VI. CONCLUSION

Countertrade is the contractually explicit linkage of commercial import and export transactions. Although variations are endless, there are three main types of countertrade: classical barter, commercial compensation, and industrial compensation.

Each type of countertrade is fundamentally inefficient, according to the general equilibrium view that dominates the literature. General equilibrium critics see countertrade as costly, inflexible, and uneconomic; they conclude that it decreases international trade and distorts the allocation of resources.

The world economy, however, is not in general equilibrium. Illiquidity and uncertainty prevail; information is imperfect; bureaucratic, political, and ideological barriers plague trade; national economies are underdeveloped. Under these conditions of market failure, the theory of the second best states that steps toward freer, "cash" trade are not necessarily desirable. Countertrade overcomes market rigidities and thus permits international trade which would not otherwise take place. Countertrade as a second-best policy is efficient. Generally, trade-enhancing effects outweigh trade-diverting effects.

Critics in the general equilibrium tradition necessarily assert that reciprocal trading arrangements violate the spirit and letter of the GATT. Because the General Agreement itself is a second-best system, however, countertrade supplements and complements the existing legal framework governing world trade.

Not surprisingly, then, the restrictive GATT provisions do not prohibit countertrade. Moreover, the scope of these provisions is limited by explicit exceptions and lack of consensus. GATT rules do not satisfactorily address the special problem of international trade and development in nonmarket and developing economies. Countertrade actually helps to integrate these economies into the GATT legal system.

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294. Czinkota & Talbot, *supra* note 117, at 173.

295. See *supra* notes 71, 161.

The contracting parties could try to bring barter-like trade within the sphere of GATT regulation, but any such amendments or side-agreements would be unwarranted and unlikely. If any country elects to complain formally, the contracting parties should view second-best countertrade policies as consistent with the letter and spirit of the GATT.

Countertrade's brisk growth has engendered two related kinds of confusion among commentators. First, the failures of the multilateral payments system spur countertrade, which seems to undermine that system. Second, countertrade appears to violate the spirit of the GATT, but the GATT is powerless to regulate countertrade. This confusion can be resolved: countertrade as a second-best policy is consistent with the goals of international legal norms because it helps the international economy to overcome the trade-reducing effects of market failure.